HOW TO FIGURE PROFIT

P. ROGER CLEARY

How to Figure Profit

A Comprehensive Reference Book
for
Business Men, Teachers and Students

By P. Roger Cleary

President Cleary College; Accountant, Auditor and Systematizer; Author of the Cleary System of Business, Bookkeeping, Accounting and Auditing; Formerly Editor of Education Extension and Chairman of the Commercial Conference of the Michigan Schoolmasters' Club and of the Commercial Section of the Michigan State Teachers' Association

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To

H. J. C.

IN

RECOGNITION AND APPRECIATION

OF

A SPLENDID COÖPERATION

HOW TO FIGURE PROFIT

is Indispensable to

THE BUSINESS MAN

Because

HIS SUCCESS DEPENDS UPON IT

HOW TO FIGURE PROFIT

is Indispensable to

THE TEACHER

Because

HE IS PREPARING THE BUSINESS MEN AND WOMEN

of

THE FUTURE

HOW TO FIGURE PROFIT
is Indispensable to
THE STUDENT
Because
HE IS THE BUSINESS MAN
OF TOMORROW

Publishers' Note

A Book of Merit

In presenting this book to the business, teaching and student public, we feel that we have something not only of interest, but of merit, of real money-making value.

It is Comprehensible

It is not a book of technical facts, comprehensible only to the trained business mind. The application of the principle of How to Figure Profit is so fully and clearly explained as to be within the grasp of the most inexperienced.

The Ideas are Based upon Experience

It is the result and happy combination of a wide business, accountancy and teaching experience. The subject matter has not been gathered from books, but from actual touch and contact with life; and, because of this fact, the book will be appreciated alike by the business man who wants to be shown, by the teacher who has been brought up on the old arithmetic idea and by the student who is preparing to grapple with the real problems of life.

The Book is Understandable

The author assumes that the idea of figuring profit on sale is new or comparatively new to, or but little understood by, at least ninety per cent of those whom the book is intended to reach; and to make it possible for them to get at once what might otherwise take days or weeks or even months, and to avoid any possibility of their giving up in despair or disappointment, he has made it possible for him who reads to understand.

The Points are Getatable

The author also assumes that those for whom the book is intended are busy people and he has therefore made it possible for them, thru a topical analysis and short, terse chapters to get the vital points quickly.

In a Word—

The book is readable, understandable, reliable, to the point, and, unlike most other books on business, confined to the one subject.

THE PUBLISHERS

June, 1918

Foreword

How The Idea Came To Me

The idea of figuring profit on sale rather than on cost, as arithmetics universally have been and are still very generally teaching it, came to me thru practical business and accountancy experience and personal contact with successful business men, to whom I feel indebted for the many courtesies extended me.

My Teaching—My Practice—My Books

For years past I have been teaching my students to figure profit on sale and have been applying the same principle in my accountancy practice.

The Cleary System of Business, Bookkeeping, Accounting and Auditing, widely used in the public schools and colleges, teaches the same idea, not as a theory, but as a basic principle of business.

Unconsciously They Developed The Book

But for my students, with whom I have been in close touch, and for the business men whose clubs and associations it has been my privilege to address from time to time, this book would not have been written.

They have been not only an inspiration and an impelling force to me, but they have opened the way for study, investigation and research as it would not have been opened had my work been confined alone to teaching or to business or to accountancy.

A Profitable Experience

Fortunately, too, my classroom experience has been with subject matter ranging from the simplest elements of bookkeeping to the most advanced stages of manufacturing and mercantile cost, and with students ranging in age from eighteen to fifty years and in education from that obtained in the rural school to that obtained in the high school, in the college and in the university and in experience from that of mere casual touch with life to years in the store, in the office and in teaching.

Set Them Right in Figuring

Addressing business men's clubs and associations has given me an opportunity to get first-hand, at close range and thru informal discussions the methods employed by different persons in the same line and in different lines. I know therefore the practices of most business men in most lines of business. I know also their needs and am sure

that the points brought out and developed in succeeding chapters will set them right in figuring profit.

P. Roger Cleary

Ypsilanti, Michigan
June, 1918

How to Figure Profit

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PART ONE

Principles of Correct Figuring

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A Reasonable Net Profit

IS

The Business Man's Right

Correct Figuring Will Produce It

AND

The Buying Public Will Pay It

I

Introduction

Mission of This Book

It is not exactly the mission of this book to teach the business man how to systematize his business, but rather to teach him how to figure profit under the varying conditions which arise in business. Business organization, business system, business management, etc., are subjects too big to be included under this head, but so closely related to it as at least to make their consideration necessary to a proper development of the subject of "How to Figure Profit".

It Will Benefit Three Classes

And, although this book is written from the standpoint of the business man and primarily for his use, the information given will be of no less value to the teacher who is preparing the business men and women of the future, or to the student who is soon to take up the duties and responsibilities of an active business career.

Value of the General Information

It is these three classes that this book is intended to reach and to set right in figuring profit.

The vast amount of general business information outside, yet directly related to, the subject under consideration is designed to lead the reader to an intelligent understanding of the correct principles of figuring profit and to furnish conclusive proof of the soundness of the principles advocated. This information will be of real value to the business man, to the teacher and to the student in learning how to use the "key" to business success.

The Completeness of The Discussion Will be Appreciated

The bare facts might be stated in a paragraph, and they would be understood by those who are now applying the principles; but those not skilled in accountancy or in the practical side of business need to be shown, and they will appreciate the fullness and completeness of the discussion of the subject under the various related heads in succeeding chapters.

Their Success is Proof

In writing this book, the author is aware that only the most successful business men are fully educated to the idea of figuring profit on sale. But the phrase "successful business men" furn-

ishes all the evidence necessary as to the soundness of the idea. If the idea were not good, successful business men would not use it; but the fact that they do use it is, in itself, proof that the idea is right, as, otherwise, they would not be successful.

All Will Come to It

The author is also aware that this book will go into the hands of many who will not at first agree with him, but before they put the book aside they will. Business men certainly will, and teachers and students will come to it, just as they have come to believe other important facts. It is necessary only to understand the practical side of business to see and appreciate what the application of the principles herein advocated means to the business man.

II

The Basis of Figuring is Wrong

Not Strange

It may seem strange that arithmetics have taught and, for the most part, are still teaching us to figure profit on cost. It may seem strange that the writers of arithmetics have not before this conceived the idea of figuring profit on sale, as successful business men figure it. It may seem strange that they have not seen the successful business man's viewpoint; and, when I say successful business man, I mean the man who has made a sufficient study of business and business system and administration to figure correctly and thru this to build up a large business.

The Principle New Even to Business Men

But it must not be forgotten that it is only within recent years that business men themselves began to figure in this way, and it is not altogether strange that arithmetic writers and teachers generally should not have gotten hold of the idea

sooner. But they must come to it. Modern business practice demands it.

The Arithmetic Idea

With few exceptions, the arithmetics tell us to add to cost the per cent of profit we desire to make and we shall have the selling price, the cost representing 100% and the selling price such per cent above as the profit desired represents.

For example, on a hat costing $2 the merchant desires to make a profit of 25%. The arithmetic tells him to add 25% to the cost and he will have a selling price that will yield him a profit of 25%.

Far from it. This sort of figuring has misled, if not absolutely sent to the wall, thousands of business men.

The Business Idea

Those who figure and teach in this way do not see that it is in the selling that the expense of doing business is incurred and that it is on the selling price that the expense must be figured, not on the cost price. If you buy no goods, you will incur no expense in relation to them. But, the minute you start the purchase order, the expense

begins and it continues until you deliver the article to your customer.. In other words, the expense involved is between the point of purchase (the price you pay for the article) and your customer (the price you receive for the article).

Distinguish Between Cost and Expense

Here, a distinction must be made between cost and expense, looking at the matter from a business and an accountancy point of view. Cost, of course, has different meanings; but for the purpose of this chapter, it means, in a mercantile business, the price paid at the place of purchase. All other outlay in relation to the article which is bought and sold we call expense, and this expense must be met in selling the article; that is, we must sell the article at a price that will cover this expense, as well as the purchase price, and a little more, as we shall later see.

It Does Make a Difference

So far as the net results are concerned, it may *seem* to the reader that it would make no difference whether we figure on cost or on sale, provided we figure correctly, provided we know the

basis of our figuring and know what we are doing in taking what we take as the basis; provided we know that a certain per cent added to a smaller number (cost) is not the same per cent of a larger number (sale), provided we know the exact cost of the goods sold, and provided, further, we wish to make enough simply to cover the expense of doing business, eliminating the net margin to which every business man is entitled.

We Cannot Get Around It

But there are too many things to be overcome; and, while it may be possible to overcome them in part, yet, no matter how we look at it, in order to add a per cent to cost which will produce a certain profit, we must *first* figure on *sale;* we cannot get around it, as we shall later see.

III

Cost and Expense Defined, Differentiated and Statistically Grouped

Cost

Not Understood, Hence Not Correctly Applied—Cost is not easily defined, since it has different shades of meaning, depending upon how it is used and the purpose for which it is used. To one person it may mean one thing, whereas to another person it may mean quite another thing; yet, to each, the meaning may be not only clear, but correct from his viewpoint.

Generally speaking, however, the term, as used by the masses, while it may seem to be clear, is not. That is, different persons using the term do not comprehend its meaning in the same light or apply it always in the same way; and, as a result, they do not all figure correctly and then they wonder why it is there should be a difference in results under seemingly like conditions.

Explanation of the Term—In general terms, Cost is applied to the price to us of the finished article, or to the price plus additional outlay, which may

be a single item or a group of items or the sum of two or more groups of items. It is comprehensible, in other words, in the light of price or of outlay by stages; that is, it has to do with the money value or the outlay at a given point or stage; as, in a retail business, at the point of purchase (Prime Cost), or at the point of delivery (Delivered Cost), or at the point of sale (Subtotal Cost), and similarly in a manufacturing business.

Different Viewpoints of Cost

To different persons, and in different businesses, and in different stages of the same business, and in different uses in each stage, cost has different meanings. Therefore, to apply the term correctly, we must consider it (1) from the viewpoint of the person using the term, or (2) from the viewpoint of the business to which we wish to apply it, or (3) from the viewpoint of the stage of progress in that particular business, or (4) from the viewpoint of the use in the particular stage to which it is to be applied, or (5) from the viewpoint of the business and the one or ones investing in the business, or (6) from the viewpoint of the bookkeeper and accountant.

That of the Person Using the Term

1. From the Viewpoint of the Person Using the Term, Cost means:

a. *To the Consumer,* usually, the price paid at the place of purchase.

b. *To the Retailer or Wholesaler or Jobber,* (1) the price paid at the place of purchase, known, in terms of accountancy, as Prime Cost; or (2) Prime Cost plus the expense involved in bringing the article or articles from the place of purchase to the place of sale, known as Delivered Cost; or (3) Delivered Cost plus the expense involved in effecting the sale and the delivery of the article or articles to the purchaser, known as Subtotal Cost; or (4) Subtotal Cost plus certain additional expense (interest allowed, especially), known as Total Cost.

c. *To the Manufacturer,* (1) the price paid for material and direct labor, known as Prime Cost; or (2) Prime Cost plus the expense involved in converting the material into salable product, known as Manufacturing Cost; or (3) Manufacturing Cost plus the expense involved in delivering the article to the purchaser, known as Subtotal Cost; or (4) Subtotal Cost plus certain additional

expense, known as Total Cost, as in a mercantile business.

d. *To the Non-Trader,* simply what it costs him to conduct or carry on his business, although in different businesses of this nature there must necessarily be different cost groups, depending upon the business. The lines are too varied to be taken up in detail here.

That of the Business

2. *From the Viewpoint of the Business,* Cost may mean one thing in a retail, wholesale or jobbing business, another in a manufacturing business and still another in a non-trading business. That is, the basis of cost is not the same in these different businesses; it is not expressed in the same terms or made up of the same elements. Therefore, we do not figure it in the same way or, necessarily, from the same basis in businesses of different kinds or always in different businesses of the same kind, since the conditions are not the same.

That of the Stage of Progress

3. *From the Viewpoint of the Stage of Progress* (cost grouping), Cost in any one business at a particular stage may not be made up of the same elements as in another business at the same or at a corresponding stage; that is, we may have to

take into consideration elements of cost in one which do not enter into another; or we may have to group differently. In other words, there is no set chart or outline which can be followed in the same or in a similar stage of progress in all businesses of the same kind or of different kinds.

That of the Use in a Particular Stage of Progress

4. *From the Viewpoint of the Use in a Particular Stage of Progress,* Cost must be differently considered. For example, in a manufacturing business, in the factory stage, certain material may go into the manufacture of a certain article; again, some of the same material may go into the repair of certain equipment necessary to produce this article; while, again, the piece of equipment may become valueless and must be replaced by new from this material.

The same material is applied to these three uses, yet different cost elements and cost groups are affected by the three different uses to which the material is applied.

That of the Business and the Investor

5. *From the Viewpoint of the Business or Venture and that of the One or Ones Investing in the Business or Venture,* Cost must be differently considered. For example:

From the viewpoint of the *business,* ledger costs or charges only can be taken into consideration in the classification or statistical arrangement of the statement.

But, from the viewpoint of the *investor,* an additional charge or deduction (from earnings) should be made in the *statement* (only) for Interest on Investment, and the statement which does not take this into consideration is not complete, whether viewed from the standpoint of accountancy or good business, as we shall later see.

The cost to the business is the outlay and the compensation for this is the earnings, the difference being Nominal Net Earnings or Profit.

The cost to the investor is the forfeiture of the interest on the amount which he invests, looking at the matter from the viewpoint of what it would bring if on secured loan, and the compensation to him for this is the Nominal Net Earnings from the capital invested as shown by the statement, the difference (between the interest and the earnings) representing a gain or a loss over placing his money on secured loan.

That of the Bookkeeper and the Accountant

6. *From the Viewpoint of the Bookkeeper and the Accountant,* Cost is closely related to Charge,

but it does not necessarily mean the same. For example:

a. *To the Bookkeeper,* Cost suggests a charge to some particular account.

b. *To the Accountant,* Cost suggests a charge not only to a particular account, but to a particular group, or class, or section, or division, of accounts; and this not only as applied to the ledger, but to the monthly and yearly statements as well.

In other words, Cost Charging for record is one thing; Cost Grouping for statistical or statement purposes is another. Both are important and necessary to correct figuring and the enlightenment of those financially interested.

Expense

Distinguished From Cost—The term Expense, as distinguished from Cost, comprehends the individual items of outlay entering into or which go to increase or to make up each cost group—the item or group of items which supplements, adds to or increases the price (Prime Cost) or any distinct or definite cost group or total following the price.

For example, at the place of purchase the Prime Cost of an article or group of articles may be

$50, which would constitute the first cost. The additional outlay in bringing the article or articles from the place of purchase to the place of sale amounts to, say, $1.05, $0.80 being for freight and $0.25 for cartage. This outlay we call Expense, since it supplements, adds to or increases the first cost. The first cost (Prime) and these two items of Expense, therefore, while they remain detached, retain their distinction or individuality as Cost and Expense, respectively; but the minute they are grouped together or merged to form a second or new cost basis to be increased by additional expense outlay of another nature, they lose their individual identity and become known simply as Cost under an appropriate title, as Merchandise or Delivered Cost. To this cost (total to this point) are added items of outlay or expense entering into another group bearing another title or name. And so on, the Expense increases and the Cost accumulates until the end (Total Cost) is reached thru the different stages of cost grouping into which the total outlay or charge is divided in the conduct of a business of whatever kind or nature.

Divisions and Subdivisions of Expense

Two Classifications — In mercantile, manufacturing and most other businesses, the items of out-

lay or charge or deduction which we call expense may be divided into two general divisions, namely, Indirect, which means to charge indirectly or thru other accounts to Capital Earnings, and Direct, which means to charge directly to Capital Earnings. Or these items may be divided into three divisions, namely, Carrying or Manufacturing, Operating or Commercial and Direct. This analysis implies that Indirect expenses may be subdivided into Carrying or Manufacturing and Operating or Commercial—Carrying and Operating in a mercantile business and Manufacturing and Commercial in a manufacturing business.

Carrying Expense—Carrying expense or charge in a mercantile business represents the items of outlay which add to or increase the purchase price, which add to the cost (Prime) or asset value of the merchandise delivered to us. And by some this is taken as the basis of cost, rather than the purchase price, and may be so taken under certain methods of figuring and cost keeping, but not as most retail merchants figure or reckon cost. The exact expense involved (and no more) should be added to the invoice price.

Expense Follows the Cost Basis—If price is taken as the basis of cost, all additional outlay in han-

dling the merchandise (including Carrying Expense if so treated) is *Indirect* expense, but not necessarily *Operating* expense. A distinction, in this case, must be made in using these two terms: that is, they should not be used interchangeably.

Indirect Expense — Since Prime Cost is taken as the basis by the author, the term Operating as distinguished from Carrying will be used rather than Indirect. It will not be out of place, however, to state that Indirect expenses or charges represent items of expense which are deductible from Capital Earnings indirectly, that is, thru accounts which are necessary to the running of the business, regardless of capitalization or how conducted, and which in themselves form a group charge to be added to a previous Group Total for the purpose of forming a new and increased Cost Basis or Cost Total. In other words, they represent items of expense which are common to all businesses of a kind or class.

Or, again, it may be stated that expenses are close, near, vital, to the operations of, or intimately related to, a business (Indirect) or that they are more or less remote or removed (Direct), such as interest allowed, which, in this case, is the result of operating on limited capital.

Or, from another viewpoint, it may be stated

that Indirect expenses are items of ledger cost or charge which find their way to Loss and Gain thru such accounts as Fuel, Light, Taxes, Insurance and similar accounts which are periodically closed to Loss and Gain.

The Natural Divisions—The expense involved in the conduct of a mercantile business whose basis of cost is the purchase price may be divided, as above, into three distinct divisions, namely, *Carrying, Operating* and *Direct*. And it is important that the line be clearly drawn between these divisions. While the first is an element of expense, yet it is also an element of merchandise cost. In the light or sense of asset value, it bears the same relation to merchandise cost that price does. These two elements, Purchase Price and Carrying Expense, therefore constitute merchandise cost or delivered cost, as you choose to call it.

Operating Expense—The operating expense, the outlay involved in the regular course or conduct of the business, begins (except as preceded by purchasing expense) at the point of receiving the goods from the carrier; in other words, at the receiving room. It represents the items of expense involved in converting the merchandise into cash.

Purchase price and carrying expense are two

items of cost and expense, respectively, which are common to all mercantile businesses. Revenue is not possible in any business without these two items. They represent asset value and, together, can be turned into money.

It will be noted, therefore, that Carrying (if made a ledger charge) and Operating expenses together mean the same as Indirect expenses; that is, they are subdivisions of Indirect expense.

Direct Expenses—Direct expenses, on the other hand, are items of charge which are not incident to the business, which the business, as a venture, as a going concern, does not require or call for, but which the management, in a sense, forces upon it. And, since they are the result of insufficient capitalization (interest allowed, etc.), it would not be fair to the earning capacity or power of the business to include them with the operating or running expenses; in other words, to carry them as operating accounts; and, therefore, they are made a direct charge to Earnings—posted directly to Loss and Gain—or made a separate group by themselves (which is the better way) in the Ledger and in the Statement and independently charged, thru Loss and Gain, to Capital Earnings. They are made a charge group distinct from the Operating expenses in order to determine what the

business, under favorable conditions or, in comparison with other businesses of a like nature, is capable of producing.

Direct expenses are incurred, then, because of certain conditions which exist in certain businesses, but which do not exist in certain other businesses of the same kind or class as do Operating expenses.

In a mercantile business, therefore, Indirect expenses or charges are subdivided into Carrying (if made a ledger charge) and Operating (or Commercial, which means the same); and, in a manufacturing business, into Manufacturing and Commercial.

What Carrying Expenses Include—Carrying expenses (Freight, Express, Cartage and Parcel Post—In) represent the expense incurred between Prime Cost and Delivered Cost and form a distinct cost group (part of merchandise cost), bearing no more relation to operating expenses than do Direct Charges. These two groups of expenses (Carrying and Direct) should be kept separate and apart from the operating expenses in a mercantile business.

Operating Expenses in Three Divisions—Operating or Commercial expenses in mercantile businesses may be subdivided into Purchasing, Administra-

tive and Selling. They represent the expenses incurred between Delivered Cost and Subtotal Cost.

In manufacturing businesses, there may be two divisions of expense following Manufacturing Cost, namely, Administrative and Selling—not including Direct Charges; that is, Commercial Expenses may be so divided or subdivided.

Expense Grouping—Dividing and subdividing expenses in this way we call Expense Grouping, each group representing a distinct element of charge or cost to be added to a preceding division of Cost, as where Carrying expenses are added to Prime Cost to get Merchandise or Delivered Cost; Operating or Commercial expenses to Delivered Cost to get Operating or Subtotal Cost, and Direct Charges to Subtotal Cost to get Total Cost.

Statistical or Statement Divisions of Expense

Mercantile Business:	Manufacturing Business:
1. Indirect:	1. Indirect:
a. Carrying (if made a ledger charge)	a. Manufacturing
b. Operating or Commercial:	b. Commercial:
	(a) Administrative
	(b) Selling

(a) Purchasing
(b) Administrative
(c) Selling
2. Direct

2. Direct

It should not be implied that an analysis so minute as the above is necessary in every business or in any business. Three divisions will usually answer in a mercantile business, namely, Carrying, Operating and Direct; and three divisions also in a manufacturing business, namely, Manufacturing, Commercial and Direct.

Divisions of Cost

MERCANTILE BUSINESS

Cost, as previously explained, is divided into totals or group totals and is known and referred to by group titles; as, for example, Purchase or Prime Cost, Merchandise or Delivered Cost, Operating or Subtotal Cost and Total Cost, depending upon the basis taken and the purpose for which taken.

The purchase price, or Prime Cost, and the first subdivision of Indirect expense (Carrying) constitute, as above stated, what we call Merchandise or Delivered Cost, which means the cost at our store or place of sale—the asset value of the goods

or stock. Add to this the second subdivision of Indirect expense (Operating or Commercial, as you please to call it) and we shall have Operating or Subtotal Cost; add to this the Direct Charges and we shall have Total Cost, which means the total ledger cost involved in the conduct of our business—interest on investment not included, although deductible in the statement before a net profit is possible from the viewpoint of the one or ones investing in the business.

It will be seen therefore that the term Cost, as applied to a mercantile business, may mean one of four or more things, depending upon the viewpoint and the accountant's idea of grouping.

Manufacturing Business

In a manufacturing business, we have the same divisions, and the same titles, with one exception, namely, Manufacturing Cost, which we use here, as is noted below, instead of Merchandise or Delivered Cost, as in a mercantile business.

For example, what we pay for the raw material plus the direct labor put upon this material we call Prime Cost; add to this the freight and cartage and all other expenses involved, directly or indirectly, in purchasing or in converting the raw material into the finished product and we shall have Manufacturing Cost, which, in a measure,

corresponds to Delivered Cost in a mercantile business. Add to this another group of expenses (Commercial) and we shall have Subtotal Cost. Add to this still another group of expenses or charges (Direct) and we shall have Total Cost, as in a mercantile business.

If the records are properly kept in a manufacturing business, the cost of manufacturing a given article can be determined very accurately, as can also the cost of selling the article.

In either a mercantile or a manufacturing business, it is absolutely necessary to know the cost or what cost means, whatever we take as the basis, in order to figure intelligently.

Statistical or Statement Divisions of Cost

Mercantile Business:	Manufacturing Business:
1. Prime Cost	1. Prime Cost
2. Merchandise or Delivered Cost.	2. Manufacturing Cost
3. Operating or Subtotal Cost.	3. Subtotal Cost
4. Total Cost	4. Total Cost

Of course, looking at the matter in the light of accountancy or statistical grouping there may

be other divisions and subdivisions of cost; but, for the purpose of this book, for the purpose of establishing the selling price, and indeed for any purpose, for that matter, consideration need be given only to the four divisions mentioned.

The Basis of Cost

To avoid confusion in the use of the term Cost, a distinction should be made between Ledger Cost or Charge and Statement Deduction. The basis of Ledger Cost in a mercantile business is or should be Prime Cost, and, in a manufacturing business, Manufacturing Cost.

The basis of Statement Deduction may be any one of the four divisions in the preceding analysis or more, depending upon the purpose for which the basis is taken; but, contrasted with ledger charge, Nominal Net Profit is the basis.

Although freight and cartage and similar charges on unsold goods represent an asset and form a part of the cost of the goods in a financial statement, or in settling with an insurance company for a loss, or in selling the entire stock at what it would cost to duplicate the stock laid down in the store; yet this cost, or, more properly, expense, would better not be added to the Purchase Price of

merchandise in the ledger as incurred, but made a separate charge, and added to merchandise cost weekly or monthly, as explained in Chapter XXIV—unless it is added to the invoice price, thus making delivered cost the basis.

When reference is made to selling or doing business at a profit or on an even basis or at a loss, Total Cost is the basis which should be understood, except when the selling price must be taken into consideration to determine the per cent of loss, as explained in Chapter XIII.

A distinction should be made, therefore, between selling above cost and selling at a profit. In selling above cost you may be selling at a profit or at a loss, depending upon the per cent of profit, as explained in Chapter XIII.

So also a distinction should be made between selling below cost and selling at a loss. To sell at a loss does not mean necessarily to sell below cost. You will be selling at a loss if you sell at cost, and you may be selling at a loss even though you sell above cost, as is explained in Chapter XIII; that is, you may be selling at a reduction of profit as shown by the marked-up price.

Use and Apply Expense Terms Correctly

In referring to expense in terms of accountancy, note:

1. That the terms Carrying, Transportation and Trading mean the same in a mercantile business. Any one of these terms may be used as applying to Freight, Express, Cartage and Parcel Post—In.

2. That the terms Operating and Commercial mean the same in a mercantile business. They constitute the group or groups of expenses between Delivered Cost and Total Cost. They may, as previously stated, be subdivided into three distinct groups, namely, Purchasing, Administrative and Selling; but, ordinarily, it is not necessary or advisable to make these subdivisions. The expenses in most mercantile businesses need be divided into only three groups, namely, Carrying, Operating and Direct.

In a manufacturing business, the term Operating has too wide a range of meaning to be used as applying to the expenses following Manufacturing Cost. The term Commercial is a more appropriate one to use.

As in a mercantile business, only three divisions of expense *need* be made, namely, Manufacturing, Commercial and Direct, the former being to Raw Material and Productive Labor what Carrying Expense is to Purchase Price in a mercantile business (See Chapter IV).

3. That the terms, Direct and Extraordinary mean practically the same in any business, and apply especially to interest allowed. The term Direct is the more applicable perhaps, especially if followed by the word Charges.

IV

Cost Analysis of Manufacturing and Mercantile Businesses

Manufacturing

The Business is Varied—The business of manufacturing, like that of merchandising, is varied. It has reached the point of extreme specialization. Business men have come to see that it is in the specialties that money is made. They no longer take the timber from the stump, for example, and deliver it in the form of furniture to the home. A factory is equipped now for a distinct line of work or set of operations with quality or volume, the objective.

Three Elements Enter Into Manufacturing Cost—The manufacture of any article or line represents three distinct elements or divisions of cost, namely, Raw Material, Productive Labor (these two constituting Prime Cost) and Manufacturing Expense.

These three elements constitute Manufacturing Cost, or the cost to manufacture, and the line should be drawn here, as it would be if the manu-

factured articles were purchased from another plant in the regular course of merchandising—Merchandise or Delivered Cost.

In other words, Manufacturing Cost is to a manufacturing business what Delivered Cost is to a mercantile business, except that the cost to manufacture an article in a given line for sale should be less to the manufacturer than the Delivered Cost of the same article from another plant in the same line, because Delivered Cost to the buyer includes a gross profit to the seller (sufficient to cover the Commercial and Direct expenses, Interest on Investment and a Net Profit); otherwise the seller would not be in the manufacturing business—if he knows how to figure profit.

Other Divisions of Cost—But the above has to do with manufacturing or production cost only. It does not include the cost of administration and selling, which we call Commercial Expense or the cost which we call Extraordinary Expense or Direct Charges, should such expenses or charges be incurred.

The Commercial Expense added to Manufacturing Cost will give what the author chooses to call Subtotal Cost—See Figure 1 following.

Add to this the Direct Expenses (which will

give Total Cost) and Interest on Investment (See Chapter XXVI) and the Net Profit you desire to make and you will have the Selling Price, the price at which the article should be sold, as in a mercantile business.

The Different Cost Divisions Explained—Figure 1 will help to fix the divisions of cost, the deductions, net profit and selling price clearly in your mind.

While this diagram is intended to portray a manufacturing business, it also portrays a mercantile or selling business, Manufacturing Cost corresponding to Delivered Cost in a mercantile business, and from this point on there is practically no difference; both are selling businesses.

In a manufacturing business, Manufacturing Expenses and Commercial Expenses should not be confused.

Neither should Manufacturing Cost and Subtotal or Total Cost be confused. The cost to manufacture and the cost to sell are two distinct groups of cost. They do not mean the same in considering the matter of cost and should not be used interchangeably.

And do not confuse Total Cost with Total Deductions.

Total Cost means the total ledger outlay in-

volved in the conduct of a business, or the total charges against or deductions from earnings as shown by the ledger.

The total cost of doing business is deducted from the total earnings resulting from the conduct of the business; and, from the remainder, what is left, an additional deduction is made of the interest on the investment (See Chapter XXIII), which, together with previous deductions, constitutes Total Deductions—Figure 1.

The top squares in the diagram (Figure 1), 1 to 5 inclusive, are intended to show the respective per cents (or total) of profit which the margin between Prime Cost and Selling Price represents; in other words, the profit which must be made on every dollar's worth of goods sold in order to do business on a sound or safe basis.

The Basis of Cost—Therefore, fix your basis of cost—Prime, Manufacturing, Subtotal or Total—and then go ahead intelligently with your figuring according to what you desire to accomplish thru figuring. If your purpose is to establish the selling price, however, take Manufacturing Cost as the basis.

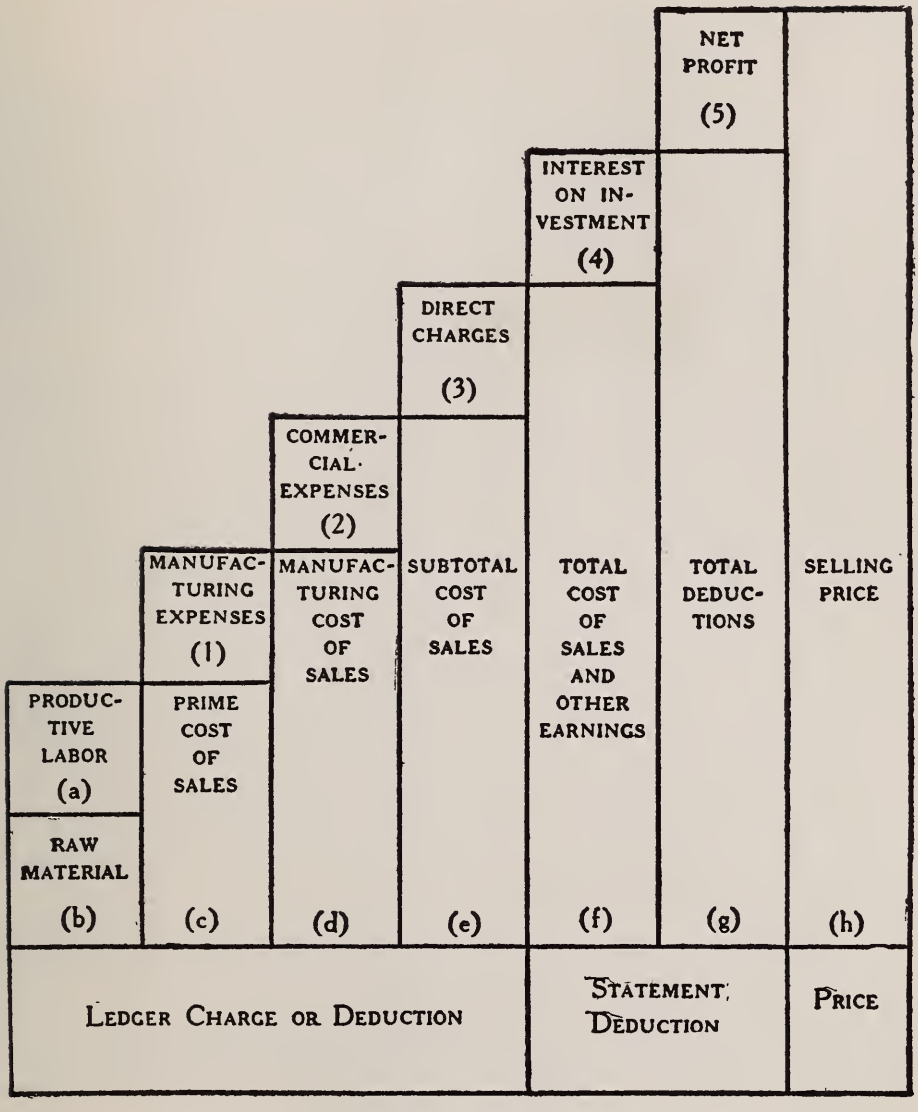


FIGURE 1

Note — This Diagram Shows the Grouping of Costs, Charges and Net Profit in a Manufacturing Business with a View to Fixing the Selling Price.

Figure 1 Explained

The small squares at the top of this diagram, numbered, respectively, 1, 2, 3, 4 and 5, represent the respective divisions of profit which must be made on every dollar's worth of goods sold to meet the ends for which the business is established and for which the investment is made.

The amount of each of the first four groups, in dollars and cents, for, say, one year or one month or one week should be ascertained from your books or from as close an estimate as you can make if you do not keep a set of books.

Each amount so ascertained, or the sum of the respective amounts, should be divided by the total sales for the same period of time and the result will be the per cent to sale. To this per cent add the per cent represented by number 5 and you will have the *average* per cent of profit which you should make on sale.

Now, add the *equivalent* of this per cent (the per cent added to the smaller number, Cost, which will produce this per cent on the larger number, Sale—Chapter XIX) to Manufacturing Cost and it will give you the correct selling price.

Beginning with "Prime Cost" (c), this diagram illustrates also the grouping of costs in a mercantile business—Figure 2, following, which see.

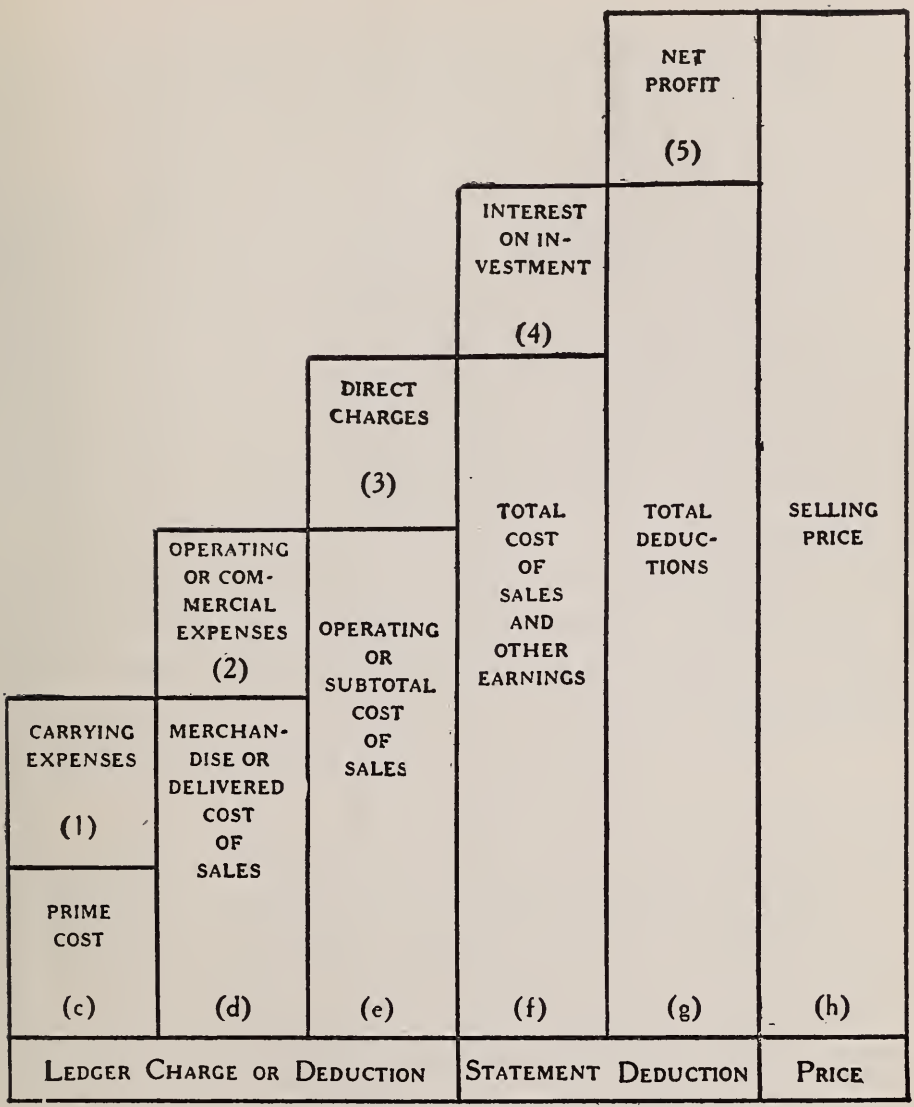


FIGURE 2

Note — This Diagram Shows the Grouping of Costs, Charges and Net Profit in a Mercantile Business with a View to Fixing the Selling Price.

The cost terms used in this diagram and the divisions of cost are fully explained in Chapters III and XXIII.

Referring to Total Cost (f), in almost every business, in addition to the earnings resulting from sales, there are earnings resulting from discounting bills (Cash Discount) and from interest on notes taken on account or in lieu of cash (Interest Earned), etc. Hence the Total Cost represents a deduction from "Sales and Other Earnings".

The explanation of Total Deductions (g) given above will be found sufficiently clear for the present. Chapter XXIII takes up this division more minutely.

Mercantile

Wherein They Differ—The essential difference between a mercantile and a manufacturing business lies in the fact that the mercantile business buys the goods or articles which it sells and in the same form or state in which it sells them, except as to quantity or bulk, whereas the manufacturing business makes or produces them; that is, it buys the raw material and converts it into the product which it sells. Both are selling busi-

nesses, but one is exclusively so, buying the identical thing or things which it sells, whereas the other manufactures or makes from raw material that which it sells. In other words, the chief business of the one is to sell goods; of the other, to manufacture goods.

Another point of difference, however, lies in the fact that, in a manufacturing business, manufacturing cost, which includes freight and cartage, is taken as the basis of cost, whereas, in a mercantile business, prime or purchase cost is usually taken as the basis, freight and cartage being carried as a separate charge, although forming a part of merchandise cost, and reduced in proportion to sales or added to merchandise cost weekly, the latter being the better way.

Divisions

Mercantile businesses may be divided into General, Specialty and Department, the difference being simply in classification and magnitude. Or, from another point of view, and as will be explained in another chapter, these businesses may be divided into Independent, Dependent and Interdependent.

A General Mercantile Business, or General Store, as it is called, is one which carries a small quantity of different lines of merchandise. Such a store

may be found in small hamlets or towns and in the outskirts of large towns or cities. The general store, however, as formerly conducted, is coming to be a thing of the past.

A Specialty Business is one which carries a distinct or exclusive line on a large scale, as furniture or clothing or furnishings or groceries or the like. Such businesses are springing up rapidly in medium-sized and large towns and cities. This may properly be termed an Independent business.

A Departmentized Business, or Department Store, or Interdependent business, as it may properly be called, is a combination of two or more specialty or independent businesses on the same large or even larger scale, each specialty being considered a department or store in itself.

These businesses vary in number of departments from two to three in a small city to one hundred or more in some of our large cities, different persons having different ideas as to departmentization aside from economic or other reasons. Even a so-called specialty business may be subdivided or departmentized. Departmentization is a business study, and, as a business grows, departmentization grows with it. The extent to which one should departmentize will depend upon the nature and the magnitude of his business.

Regardless of the kind of business, the cost analysis will be as shown in Figure 2, which see.

A comparison of this with Figure 1, preceding, will show the similarity of the selling ends of the two businesses.

The explanation of the diagram (Figure 1) will also apply to Figure 2.

V

Confusion of Cost Elements Must be Avoided

Manufacturing Business

As stated in Chapter III and shown in Figure 1, Chapter IV, the two elements which enter into Prime Cost are Raw Material and Direct Labor. No matter what be the line manufactured, or whether the business be small or large, these two elements constitute Prime Cost.

But, in different businesses, the per cent of the one element to the other differs. In one business the raw material may be the large item; whereas, in another, the direct labor may be the large item. But, in any manufacturing business, only these two items enter into Prime Cost. All other items of outlay must be treated as Expense.

But it is possible to confuse raw material with factory supplies and other items properly classed as expense. Raw material is that which is present in and becomes a part of the finished product, that which gives it shape and size and appearance and quality; but not the elements used in developing

shape and size and quality, as oil, grease, rags, fuel, light, etc. These are classed as expense.

So also it is possible to confuse direct or productive labor with indirect or non-productive labor. Direct labor, as an element of Prime Cost, is that which directly changes the raw material into the finished product, as distinguished from indirect labor, which merely assists, as superintendent, foreman, fireman, engineer, janitor, watchman and like service. These must be classed under indirect labor, and this in turn under Manufacturing Expense (Chapters III and XXIII).

Therefore, in distinguishing Prime Cost from Expense, in a manufacturing business, the line must be clearly drawn between that which is direct and that which is indirect in order to insure correct figuring.

Mercantile Business

In a mercantile business, as has previously been explained, only one element is present in Prime Cost, namely, purchase price. All other elements of outlay are expense or charge, whether Carrying, Operating or Direct or some subdivision or modification of these.

VI

Raw Material and Finished Product Differentiated

The state or condition in which one receives material is *raw;* that in which he parts with it is *finished.* Therefore, finished product to the seller may be raw material to the buyer.

For example, if a person's business be that of buying timber in the stump and selling it in the log, to him the stump will be raw material, whereas the log will be finished product.

The person who buys these logs may be a lumber manufacturer. To him the logs will be raw material, whereas the lumber into which the logs are sawn will be finished product.

The person who buys this lumber may be a furniture manufacturer. To him the lumber will be raw material, whereas the furniture will be finished product.

The person who buys the furniture sells it in the same form as he buys it. He is therefore a merchant, not a manufacturer, and the one who buys of him does so for his own use and is therefore a consumer.

Thus you will note the stages or processes between the producer and the consumer. You will note also the value which each process adds to the material in its original or raw state and the proportionate increase of cost to the buyer.

The process of converting the raw material into finished product we call manufacturing. This process may be either hand or factory. The hand process has given way largely to the factory process, due to the invention of machinery, which makes possible not only better work, but a greater volume as well.

VII

Some Conditions Which Affect Cost and Profit

The Middleman

It must be clear even to the inexperienced that the more hands thru which an article passes in its finished stage before reaching the consumer, the higher the price to the consumer, since each one must make a profit. This does not mean that the price to him would be less if he bought first-hand while the middleman remains, for the manufacturer or the producer, as the case may be, knows the number of hands thru which the article should pass before reaching the consumer and about the price at which it would be finally sold, and he must of course protect the trade—his best customers, those who buy of him in large quantities—and if he sells to consumers at all, it will be at an increased price from that made to large buyers. But most manufacturers and wholesalers will not sell direct to consumers at any price.

In Theory

In theory, the manufacturer buys from the producer; the wholesaler from the manufacturer; the

retailer from the wholesaler, and the consumer from the retailer; but, in practice, conditions are quite different, and it is of the practical side of business that this book treats.

In Practice

In practice, the manufacturer buys from the manufacturer or from the producer, depending upon what he buys; the wholesaler from the manufacturer or from the producer; the retailer from the wholesaler, from the manufacturer or from the producer, depending upon the line carried and the volume; and the consumer from the retailer, from the manufacturer or from the producer, depending upon the nature of the thing bought and whether the manufacturer sells direct or thru middlemen.

The Sale Price

With some sellers, whether they be producers, manufacturers or wholesalers, the sale price is uniform and made to a particular class of customers; whereas, with others, the sale price varies according to volume, whether the buyer be a manufacturer, a wholesaler or a retailer; that is,

prices are quoted on a basis of quantity, but the average price, even the price made to the heaviest buyers, must be high enough to yield a satisfactory gross profit from the viewpoint of expense and net profit to sale.

The Price May or May Not Vary

In other words, the price will or should be about the same to all buyers in the retail trade within the limits of a certain volume of business and for the same grade of goods; and hence the price which they, in turn, make to their customers will or should be about the same. Their expense of doing business may vary slightly, but the difference will be so small in rightly managed businesses as to make a variation in price to their customers impossible without cutting into profit, volume-buying considered.

Therefore, it will be seen that, within a certain volume of business and upon a basis of the same grade of goods, the price to retail buyers will be about the same in all businesses of a given line; and, since this is true, volume considered, the price which they, in turn, make will be about the same if a uniform profit is to be made. If a fixed, definite profit for a definite purpose is not con-

sidered, then there may be a variation in the price; as where one merchant attempts to undersell another, or where the price is fixed by guess, as is often the case, or as a result of figuring on a wrong basis.

When the price to retail buyers varies according to volume, the larger the volume the larger the profit or the lower the price which the retail buyer, in turn, can make (expenses being equal), provided volume-buying does not mean over-stocking or over-capitalizing or both. Stock must be turned promptly to make the investment profitable. Therefore, the buying end of a business needs the same attention, judgment and skill as the selling end.

VIII

It Makes a Difference How We Figure

The Basis Must Be Established

In a mercantile business, the relation which cost bears to sale depends entirely upon the viewpoint—upon what we, as explained in Chapter III, take as the cost basis. If our idea of cost be the price we pay for an article (Prime Cost), that is one thing; if Delivered Cost, that is another; if Subtotal Cost, that is another, and, if Total Cost, that is quite another.

The basis of cost, therefore, must be established and our reason for establishing this particular basis rather than some other basis must be not only clear, but right before we begin to figure.

If we establish Prime Cost as the basis, as in fixing the selling price in a mercantile business, we must add to this the *expense* of doing business in order to arrive at the *cost* of doing business. Make a distinction between the *expense* of doing business and the *cost* of doing business (Chapter III, preceding), and do not forget that the *expense* of doing business is figured on *Sale,* not on Cost.

Add The Equivalent to Cost

In arriving at your figures, you must ascertain the relation which the *expense* of doing business bears to *Sale,* not to Cost. And bear in mind that the per cent thus arrived at is not the one to be added to Cost to get the cost of doing business, but the *equivalent,* the per cent which, if added to Prime Cost, will produce the per cent shown by the relation of expense to sale. In other words, divide the per cent of gross profit by the per cent of cost and the result will be the per cent (equivalent) to add to cost. (Chapter XIX).

For example, if it is found that the expense to sale, arrived at by dividing the expenses for a given period by the sales for the same period, equals 20%, which must be gotten first, the expense to Prime Cost, arrived at by dividing the expenses for a given period by the Prime Cost for the same period, will equal 25%. This may be proved by taking any article at any price and adding to it 25% of the cost price and the amount so added will be 20% of the sum of the two or the selling price.

Take a hat costing $1 and add to this cost 25% (¼) and you will have a selling price of $1.25. Now, the amount added ($0.25) is only 20% of

the sum of the two items—$1 plus $0.25; that is, 20% of $1.25 is $0.25.

Find the Expense to Sale

But, you say, since this is true, why not add 25% to prime cost at once and thus figure on cost and not take the 20% on sale into consideration at all? Theoretically, this would work, as most problems in arithmetics are worked, but, practically, it would not. Since the expense of a business is incurred in doing business, in selling, in delivering the article from the place of purchase to the consumer, the expense to sale must be established before the expense which is to be added to prime cost can be determined. If the required profit on sale were always 20%, then we would always add to prime cost 25%; but, even so, it must not be forgotten that the per cent added to prime cost is the result of the relation of expense to sale, hence the per cent of expense to sale must first be determined. No matter how we look at it, we must first get the per cent which the expense of doing business bears to sale.

The Per Cent of Profit Not Uniform

It is not a fact, in any business, that a uniform per cent should be added to prime cost or that a

uniform profit can be made on sale. As stated in another chapter, the selling price is fixed by supply and demand, or by competition, or by the *selling qualities* of the article, correct figuring assumed. But, in any case, if the selling price cannot be so fixed as to permit of a reasonable profit, either the prime cost or the expense of doing business must be reduced (if reduction be possible thru good buying and good management) or a line that will produce a reasonable profit substituted.

It is the Average Profit Which Counts

This does not mean that articles which will not yield a reasonable profit should not be carried in stock, but that the *total* sales should yield a reasonable profit. The prime cost of a half dozen articles may be the same, regardless of the business, yet they may sell at different prices, depending upon the selling qualities of each. This does not mean that only the article bringing the highest price should be carried in stock. They may all be necessary to a successful business, but the good seller (price as well as demand) must bring the poor seller (sale price) up to a point where the *average* of the two will yield a *reasonable* profit.

Again, the selling price of a half dozen articles may be the same and yet the prime cost not the same, but a satisfactory profit is necessary to a successful business.

Large Buyers Have An Advantage

If the Prime Cost is to be reduced, it will ordinarily be thru volume-buying. This may or may not mean buying direct—cutting out the middleman.

A retail merchant may buy direct if he can buy in large enough quantities, but this means increased sales—a larger business. Hence, the large city merchants can buy to better advantage than the country merchants, and, by reason of this, sell at a lower price and the same per cent of profit, or at the same price and a larger per cent of profit; and, in either case, they can make more money (a larger volume), since a lower price means increased sales and more rapid turning of investment or, the same price, larger profits.

Another advantage which the city merchant has over the country merchant lies in the fact that he can replenish his stock daily or several times a day if he needs to and thus conduct his business on a smaller investment and turn his stock more rapidly.

IX

Profit Defined and Methods of Figuring Explained

Definition and Explanation of Profit

Every business conducted for the purpose of making money yields on every dollar's worth of goods sold what we call a profit, which means sale over cost.

Definition—Profit, therefore, in a Mercantile business, subject to the modification mentioned in the next paragraph, is the margin or difference between Prime Cost and Selling Price or, in a Manufacturing business, between Manufacturing Cost and Selling Price.

Explanation—The right to use the term profit in this sense, however, without qualification, may be questioned, since it admits of three constructions, namely, Gross, Nominal Net and Net; and, hence, because of the possibility of misconstruction or misunderstanding, it is deemed best to qualify the word profit by prefixing Gross, Nominal Net or Net, as the case may be, whenever doubt or confusion might otherwise arise.

Sale over Cost, then, regardless of what we take as the cost basis, we shall hereafter designate as Gross Profit, Nominal Net Profit or Net Profit, as the case may be.

Taking Prime or Manufacturing Cost as the basis, the items of outlay or charge intervening between this and Total Cost are, as explained in Chapter III, Expense, which, in a mercantile business, is subdivided into Carrying, Operating and Direct, the second, in turn, being subdivided into Purchasing, Administrative and Selling, or at least it may be so subdivided.

The important thing here, however, is to distinguish between Cost and Expense and to determine how much of Gross Profit (the margin between Prime Cost and Selling Price) each division of expense consumes.

While the margin between Prime Cost and Selling Price remains intact, subject to reduction from the viewpoint of ledger charge, we call it Gross Profit. As deductions are made for the respective expense group charges, this margin of Gross Profit becomes smaller and smaller until the last deduction (Direct Charges) is made, when what remains becomes known as Nominal Net Profit, all ledger burden or cost having been eliminated or deducted.

The Margin of Profit Not Always Sufficient — Of course, it is not always true that the margin of gross profit is sufficiently large (and in too many cases it is not) to meet the demands made upon it by the numerous deductions of expense cost, much less to include a margin of Nominal Net Profit, which means, as above stated, free or clear of all burden or weight from the viewpoint of Ledger charge.

But, in a rightly conducted business, under normal conditions, there will be a margin of Nominal Net Profit, from which a Statement deduction should be made for Interest on Investment, leaving a margin which we call Net Profit, profit in fact as well as in name, that is, from the viewpoint of the investor or investment.

The Basis of Figuring Not the Same in All Businesses — Whereas, in a manufacturing business, Gross Profit is the margin or difference between Manufacturing Cost and Selling Price, in a mercantile business, it is the margin or difference between Prime Cost and Selling Price; or, if Merchandise Cost is taken as the basis (as it may be after the selling price and the expense to sale have been established and the carrying expense has been closed to Merchandise), between that and Selling Price.

In other words, Gross Profit is the margin between the cost and selling price of the finished article or product, that which is carried or handled in the usual course of trade, whether purchased or manufactured.

In a mercantile business, the prime cost stage represents the article as finished, though not ready for sale or delivery to the customer, since it must first be "carried" or brought to the place of sale.

In a manufacturing business, the article or product at the prime cost stage is not finished. As a matter of fact, prime cost in a manufacturing business does not represent a distinct stage of progress, but rather, elements of cost distinct from that which we call expense. The article in process does not reach the salable stage until the process of manufacture, thru the blending of the three elements of charge we call Raw Material and Productive Labor (Prime Cost) and Manufacturing Expense, is completed.

For the purpose of fixing the selling price, therefore, the cost basis in a manufacturing business should be Manufacturing Cost and, in a mercantile business, Prime Cost.

Methods of Figuring Profit

In a mercantile business, therefore, Gross Profit

means, as previously stated, the difference between Prime Cost and Selling Price.

For example, if you buy hats at $3 each and desire to make a gross profit of $1, you will sell them at $4.

The gross profit here is $1, the difference between the price you pay for the hats and the price at which you mark them for selling. You simply add $1 to the cost price and it gives you the selling price. In other words, you add 33⅓%, or ⅓, to the cost price in this case and it gives you the selling price of $4.

Amount Definite and Per Cent Definite Not the Same—This is exactly the thing to do if the desired gross profit be $1, but it is not the thing to do if the desired gross profit be 33⅓%. There is a difference between making a gross profit of $1 and making a gross profit of 33⅓%. While they appear to be the same, they are not.

If you are thinking simply of fixing the selling price at a certain amount, you add an amount to prime cost which will equal the selling price desired, and it is immaterial whether you do this arbitrarily or by percentage.

For example, if an article costs $1.50 and you wish to sell it for $2.25, you simply add $0.75 to

the cost price, or you may add 50% to the cost price and you will get the same result.

But, when you speak of *making* a certain profit, you must look at the matter differently; and here you must distinguish between making an *amount* definite and making a *per cent* definite.

If you wish to make $0.75 gross profit, you will simply add $0.75 to the cost price; but, if you wish to make 50% gross profit, 50% added to prime cost will certainly not produce the gross profit you desire. In other words, there is a difference between *adding* 50% and *making* 50%. To add 50% means simply to add ½ to prime cost; that is all there is to it. But, to make 50% you must add 100% and actually sell the article; hence, it is in the selling that you make. No matter what you add to prime cost, you will not make a cent on the article unless you sell it.

Therefore, since it is in the selling that you make the profit, it is on the selling price that you figure the profit you desire to make, gross, nominal net or net, as the case may be. Hence, if you desire to make 50% gross profit, you add to prime cost not 50%, but 100%, as previously explained.

You are Being Misled—The arithmetic will tell you that the buying or cost price, whatever it be, is always 100%.

For example, if you buy hats at $3 each, the arithmetic tells you that you are buying them at 100% and that, if you wish to make 25%, you are to sell them at 125%; in other words, that you are to add 25% to the cost price and you will have the selling price.

By this method you are selling the hats at $3.75 (25% added to cost) and you are led to believe that you are making 25% gross profit; that is, naturally, you will take 25% (instead of 20%) of $3.75 and say that your gross profit is $0.93 and that looks good, you think you are making money; but, when you look back, you will see that you added only $0.75 to prime cost. There must, therefore, be something wrong; you are not making so much money as you were led to believe. The arithmetic has been misleading you. You see that, instead of making 25%, as you were led to believe, you are making only 20%, 20% of $3.75 being $0.75, the amount added to cost.

25% added to prime cost, therefore, does not mean 25% gross profit; instead, it means 20% gross profit.

The Teaching is Wrong—Arithmetics are teaching this to boys and girls every day and giving them a wrong idea of business—misleading them. The students are being taught that which they

must unlearn if they would succeed in business.

For example, almost every arithmetic you pick up contains examples of this kind: If A buys coal at $4 a ton, at what price must he sell it to make 25%? Answer, $5.

He will make $1, but not 25%: he will make exactly 20% and this is gross. The difference between $5 and $4 is $1 and this divided by the selling price will give the per cent of gross profit, namely 20%.

Again, if A buys eggs at 18c a dozen, at what price must he sell them to make 33⅓%?

The arithmetic tells him to add ⅓ (33⅓% or $0.06) and sell them at $0.24, but $0.06 is only ¼ (25%) of $0.24 and therefore he makes only 25% gross profit.

Put it down as a settled fact that, in a mercantile or manufacturing business, profit is made in selling, not in buying, except as good buying means increased profit, a standard selling price being understood, and that it is on the selling price profit must be figured.

Of course, technically, when we speak of *making* a certain per cent or amount, it means net; but, practically, it means sale over cost, the expense of doing business not being considered as part of or in connection with the cost, but deductible from gross profit.

X

Why a Net Profit

It seems to have been wisely ordained that every person should work—either for himself or for someone else; that is, in a business owned or controlled by himself or in one owned or controlled by someone else.

One is said to work for himself when his capital is the controlling factor in the business which he supervises or manages—when he has a proprietary-managerial interest.

He is said to work for someone else when someone else's capital is the controlling factor in the supervision and management of the business.

But, regardless of whose capital is invested, the same responsibility and risk are present and the same necessity for a net profit exists.

There are advantages and disadvantages in working for oneself, as there are in working for someone else. If one works for himself, he must have capital in addition to the preparation and ability necessary to work for someone else.

He may have certain privileges in working for himself he would not have in working for some-

one else; but, on the other hand, his responsibilities are greater and the chances of losing the money which he invests in a business venture are many, even under the most favorable circumstances and conditions.

Most persons in business, for example, insure for only part of the asset value of their property. They do not think it is necessary or profitable to insure for the full value, and it is possible therefore to lose the difference between the inventory value and the insured value.

It is possible, also, for a person to lose thru theft, business depression, depreciation, obsolescence and the like; while, if the business is not properly and wisely managed (this of course is not an excuse for extra profit), the chances of losing are always against the person investing.

Therefore, as a fair and reasonable compensation for the responsibility assumed and for the risk taken, every person engaging in business is entitled to a reasonable net profit on every dollar's worth of goods he sells, and he is not a good business man if he does not make it.

But it does not require unusual business ability to make a net profit. It simply requires correct figuring.

There are thousands of men in business selling

goods for what it costs them to do business or less, and their going out of business is only a question of time. The numerous changes in proprietorship and management everywhere about us are, in large part, evidence of this.

The life of a business which does not provide for a net profit must be and is limited.

If a person cannot make at least as much or more money working for himself than he could make working for others in the same or in a similar line, including interest on his investment, he would better go out of business, free himself of the responsibility and risk incident to engaging in business upon his own account, and work for someone else.

Again a profit sufficient simply to cover the expense of doing business means that one must stand still, that he cannot grow, that he cannot expand.

A person may start in business in a rented store or in a factory, but he may later wish to buy or to build. Or, if he starts in his own store or factory, he may find it necessary to enlarge. Whichever way he starts, he will certainly wish to increase his stock and his sales accordingly. But he cannot do these things without money. Will he have the money necessary to accomplish the ends he desires unless he makes a reasonable net

profit? Not unless he uses his surplus capital, if he has any, and that spells failure. He cannot borrow money unless he is making a reasonable net profit.

Growth and expansion are the direct results of net profit and they are possible only thru the making of a reasonable net profit. A person can usually borrow capital if he is making a reasonable net profit, but rarely can he do so if he is not—that is, in the regular course.

A reasonable profit is the business man's right; correct figuring will produce it, and the buying public will pay it. What the public objects to is an unreasonable, excessive, uncalled-for profit.

Any person can become rich on a small net profit (even as low as 5%) if he pushes his business, the amount of his profit being limited only by the volume of his sales.

XI

What is a Reasonable Net Profit?

This question must be considered from the viewpoint:

1. Of the business
2. Of the business man
3. Of the public

That is:

1. What net profit is the business, as a going concern, in competition with other businesses of a like nature, capable of producing under normal conditions and proper management?

2. What net profit is the business man justly and equitably entitled to?

3. What net profit will the public pay without feeling that undue advantage is being taken of them?

It Depends in a Measure Upon the Business

From the viewpoint of the business, the per cent of profit—gross, nominal net or net—one should make, assuming that it is understood by this time

what these terms mean, depends, in a measure, upon the kind of business in which he is engaged, as manufacturing, wholesale, retail, jobbing or non-trading, and upon the line manufactured, wholesaled, retailed or jobbed; upon the volume in which sales are made in these respective lines, and upon the nature of the non-trading business.

The volume of profit will vary in different businesses in the manufacturing, wholesale, retail and jobbing lines, as well as the per cent.

Conditions Which Limit Output

The output of some businesses is limited:

1. Because of limited demand for the goods handled.
2. Because of limited capital.
3. Because of a self-satisfied or poor management.

Any one of these conditions tends to limit the volume of profit, since volume depends upon output or sale, regardless of the per cent made or attempted to be made.

The output of other businesses, operated under different conditions, is limited only by physical impossibility to meet the demand, and by this impossibility only is the volume of profit limited, assuming that the per cent is normal.

The Gross and Net Profit Made

The per cent of gross profit made in different businesses of the same kind or class, whether manufacturing, wholesale, retail or jobbing, varies, ordinarily, from 25% to 50%, with the general average of these businesses ranging, ordinarily, from 30% to 35%, which should represent a net profit of at least 5% to 10%.

The gross profit in small businesses carrying a staple line of goods of a certain class, for example, will be about 25% to 33⅓%, while that in a business carrying a line bordering on novelties will range from perhaps 30% to 40%, the former representing a net profit of perhaps 5% and the latter 5% to 10%—assuming in both cases that the business is rightly managed and that profit is correctly figured, and assuming further that the capital is in proportion to sales and that the investment is turned rapidly and that the expenses are limited to the needs of the business. Not all businesses are run in this way and not all produce the profit mentioned.

In some businesses the gross profit may not fall below 40% to 50%, but such businesses are few and far between compared to the many whose gross profit will range from 25% to 33⅓%.

Novelty and Season Goods

On novelty lines, whether clothing, dry goods, furniture, shoe or something else, a slightly larger per cent of gross profit is made than is possible ordinarily on staple lines. And there is a reason for this. In most cases the investment is larger, the sales are not so frequent and the risk is greater; and then, too, if the article is what the person wants he will pay the price.

Goods in season also will sell at a higher per cent of gross profit than will the same goods out of season or goods not affected by the season.

In any business, certain articles which are carried in stock yield a higher per cent of gross profit than certain other articles. Some articles are sold at a loss and others must necessarily make up this loss. This class of sales—those yielding insufficient profit—merchants should watch closely.

The Consumer is Interested in the Volume

Again, in certain businesses, and in the sale of certain articles in almost any business, the volume of gross profit may seem to the inexperienced large, while the per cent may be normal—reasonable and just.

Comparing the gross profit made, in certain individual sales, in one business with that made in another, it is interesting to note the impression upon the inexperienced mind which volume will make.

For example, in a certain business a certain article costing the merchant $60 will sell for, say, $90, which is low in the particular case in mind, the volume of gross profit being $30. In a certain other business a certain article costing the merchant $0.10 will sell for $0.15, the volume of gross profit being $0.05. In the one sale, the gross profit is $30; in the other, $0.05, yet the per cent of gross profit is the same in the two sales, namely, 33⅓%.

The Merchant Should be Interested in the Per Cent

If the average consumer knew that a single article purchased at retail yielded the merchant a gross profit of $30, he would say that advantage was being taken of him; but he would think nothing of allowing the merchant five cents profit on a fifteen cent article. It is the volume which concerns the consumer, but it is the per cent which *should* concern the merchant. And yet the average merchant today measures his profit by dollars

and cents, rather than by per cent, and *thinks* he is making money, whereas per cent measurement would enable him to *know*. If he watches the per cent and does not allow it to go below normal, the volume will take care of itself if he pushes his sales.

The Per Cent Depends Upon the Expense to Sale

Granting that every business—manufacturing, trading and non-trading—should produce a fairly uniform per cent of net profit, the per cent and volume of gross profit will, as previously stated, vary widely.

In considering the gross profit which different businesses should produce, a distinction must be made between businesses which manufacture or carry in stock the goods which they sell and those which simply act between the producer or manufacturer and the wholesaler or retailer, who, in turn, sells to smaller buyers. Persons so engaged are properly styled jobbers, though commonly known as wholesalers. They do not handle the goods; they do not even see them; but they do, as in a wholesale business, acquire and pass the title. They buy and sell in large quantities—carload lots, and, generally, by wire, the mail even

being too slow. The sales volume is large, in proportion to which the expenses are low, and hence the gross profit will usually be as low as 5%, 3% and in some cases 1% or less.

The per cent of gross profit which a person should make, therefore, will depend entirely upon the nature of the business in which he is engaged, as manufacturing, wholesale, retail, jobbing, etc., and the kind of goods handled. It is sufficient to say that, if the business is to be successful and the investment profitable, the per cent of gross profit must be large enough to cover all expenses (Indirect and Direct), interest on the investment and a reasonable net profit besides.

Five to Ten Per Cent Net

And now we return to the question, What is a reasonable Net Profit? This cannot be answered in a word. It may be said that a person is entitled to all he can make; but to this should be added—"in fairness to all concerned". It is undoubtedly true that some take advantage of opportunity; but opportunity comes and goes, while reasonableness, fairness and justice are or should be with us always. Opportunity as referred to here, of course, has reference to the

regular course of trade, to the sale of staples—the necessaries of life.

In its economic sense Opportunity is the business man's big study. He should not only know what it means, but when and how to take advantage of it. Opportunity in this sense is a benefit not only to the one taking advantage of it, but, thru his foresightedness, to all who may in any way be affected by his operations.

Henry Ford, for example, has made millions in a brief time thru placing on the market the right thing at the right time and at a price which has added to the pleasure and prosperity of millions of persons in all walks of life.

If all men would use their minds, as Mr. Ford has used and is using his mind, the world would be the better for it.

Since the average business is established for private gain, it is the convenience, service, security and fairness to the public that will increase the net profit—the gain. Selfish motives may win for a time, but they are bound to react.

From the viewpoint of the business, the business man and the public, 5% to 10% net profit is fair, reasonable and just. Any business properly managed and operating under reasonably favorable conditions will produce this profit; any busi-

ness man who pushes his sales will get rich from this profit, and the public will pay it without a whimper.

Most Business Men Do Not Make Enough

But every business man does not make 5% to 10% net profit on his average daily sales—due of course, in large part, to incorrect figuring. In normal times, more make under 5% than over, while, as stated in another chapter, many simply break even or run behind and sooner or later go out of business—sell out to the other fellow who, in turn, tries his luck; and, with him, and others who figure incorrectly, it is luck.

It is true that a few businesses make more than 5% net profit, some as high as 10% to 15% and even more; but, in normal times, they are few and far between—that is on sales. Cash discount and other earnings will increase the per cent of course.

Dividend and Profit Not the Same

Because certain businesses pay their stockholders an annual dividend of 50% to 100% it must not be inferred that a net profit of 50% to 100%

is being made. These are two different propositions. Dividends are figured on capital invested, while net profit is figured on sales. And the smaller the investment in proportion to sales, the larger the per cent of dividend, which is declared on a basis of the dollar invested.

Reasonable Profit and Large Sales

A large dividend is not the result of a large net profit on small sales so much as a reasonable net profit on large sales. That is, it is possible to put the selling price so high as to reduce the sales even to the point of losing money; or it may be so placed as to increase the sales to a point that will show a reasonable net profit.

Regardless of the kind or nature of the business, it should be the aim of every business man to make 5% and more if it will not react upon the sales. Certain manufacturing and a few mercantile lines, as above stated, will make 10% and possibly more without affecting the sales. But this may be due in part to close buying and watching expenses.

Reducing the per cent of net profit with a view to increasing the volume thru increased sales may be wise in some cases, but the merchant must

know what he is doing. He must be sure that he is increasing the sales without increasing the expenses in the same ratio. It is due the buying public as well as the business man himself that expenses be kept in proportion to sales.

Decide Upon the Profit and Push the Sales

Settle upon the per cent of average net profit you propose to make, whether this be 5%, more or less—what the business is capable of producing and what is fair to the buying public—and then push your sales to the limit and you will make money, the volume being limited only by the sales. But eliminate net profit entirely and you may push your sales into the millions and you will be no better off financially at the end of the year than you were at the beginning, if as well.

XII

Profit Too High or Too Low Means a Losing Business

There is just one way of figuring profit and that is the *right* way. If you figure too high you will lose trade; your customers will go elsewhere or go without and you will lose the trade correct figuring would bring you. Not only will you decrease the volume of net profit, but you may eliminate it entirely—even run behind.

If you figure too low, you will lose money on every dollar's worth of goods you sell.

The remedy is to buy at the closest figure you can, direct or thru the middleman, depending upon the volume of your sales, to list and figure your expenses and interest on investment accurately and ascertain the relation in per cent which they bear to sale and add to this per cent the per cent of net profit to which you are entitled and then add the *equivalent* per cent to cost (if the *selling qualities* of the article permit) and you will make good if you push your sales.

But be sure to list your expenses correctly. Take into consideration the business in which

you are engaged and do not omit or underestimate a single item of expense, however small, incident to the business.

Above all, do not estimate or take for granted. Get down to brass tacks, so to speak. Do not overlook your own salary (what you could get working for someone else in the same line), the interest on your total investment (the going rate), depreciation, etc.

Interest on investment must be taken into consideration not only in charting your expenses with a view to fixing the selling price, but also in the statement with a view to comparing the value of the investment with that which pays a fixed rate of interest, and which we commonly call secured loan; but it must not be made a ledger or operating charge in the running of your business. The government will not allow it in annual reports and it should not be considered in the regular course of account-keeping.

Additional information touching upon this subject will be found in Chapters XXIII, XXIV and XXVI, as well as in preceding chapters.

XIII

Prime or Manufacturing Cost, Gross Profit, Loss and Selling and Sale Prices Illustrated and Explained

General

As previously stated, cost may be viewed from one of four points, namely, Prime or Manufacturing (as the case may be), Delivered, Subtotal or Total, depending upon the purpose for which the cost is desired. Prime or Manufacuring Cost is taken as the basis for establishing the Selling Price in Figure 3, Scale 1, following.

Gross Profit, as has already been explained, means the margin between Prime Cost in a mercantile business or Manufacturing Cost in a manufacturing business and the Selling or Marked-Up Price (100%) and includes or should include the Carrying or Manufacturing (as the case may be), Commercial and Direct expenses, Interest on Investment and a reasonable Net Profit—Figure 3 following.

Gross Profit May be Sufficient or Insufficient—Gross Profit therefore may cover simply the expense of doing business, or even less, or it may be sufficient

to cover the expense of doing business and interest on investment and a net profit as well, depending upon the Selling or Marked-Up Price. That is, thru placing the Selling Price too low, the Gross Profit may be reduced to a point that will merely cover the expense of doing business or less, or it may be increased to a point that will include a net profit over all. Study Figure 3.

The difference between Prime or Manufacturing Cost (Scale 1) and Selling Price (100%), whether it be large or small, represents Gross Profit, whether sufficient or insufficient. The per cent of Gross Profit may vary from "0" to 100, depending upon how high the Selling Price is placed (Scale 2 A to I).

Viewed from the Selling Price of 100%, the Cost (Prime or Manufacturing) will be low or high on the per cent scale (Scale 1) from "0" up, depending upon the per cent of Gross Profit (Scale 2) or Loss (Scale 3). As the Gross Profit (Scale 2 A to I) increases or goes up the scale, the Cost (Scale 1) decreases or goes down the scale in the same ratio. But as the Gross Profit decreases or goes down the scale, the Cost increases or goes up the scale in like ratio.

For example, if the Gross Profit on sale is 25% (Scale 2 F), the cost will be 75% (Scale 1 F).

If the Gross Profit is 50% (Scale 2 G), the cost will go down to 50% (Scale 1 G), and so on, the Cost decreasing in the same ratio that the Gross Profit is increasing. If the Selling Price is placed so high as to bring the Gross Profit up to 75% (Scale 2 H), the Cost will go down to 25% (Scale 1 H). If the article sold was given to the seller, the Gross Profit would go up to 100% and the Cost down to "0".

On the other hand, if the Gross Profit is eliminated (Scale 2 A), by marking the article down, the Cost will go up to 100% (Scale 1 A), the increase in Cost being in the same ratio as the decrease in Gross Profit.

From the standpoint of any cost basis, 100% gross profit is not possible. If the article sold was given to the seller, then of course the sale would represent a gross profit of 100%.

Neither is 100% loss possible since, if you give the article away, you treat it as a sale and charge the amount to an appropriate expense account.

The Diagram Explained

In the accompanying diagram (Figure 3), Scale 1 represents Prime or Manufacturing Cost to Sale Price, and this is true whether the Sale Price be

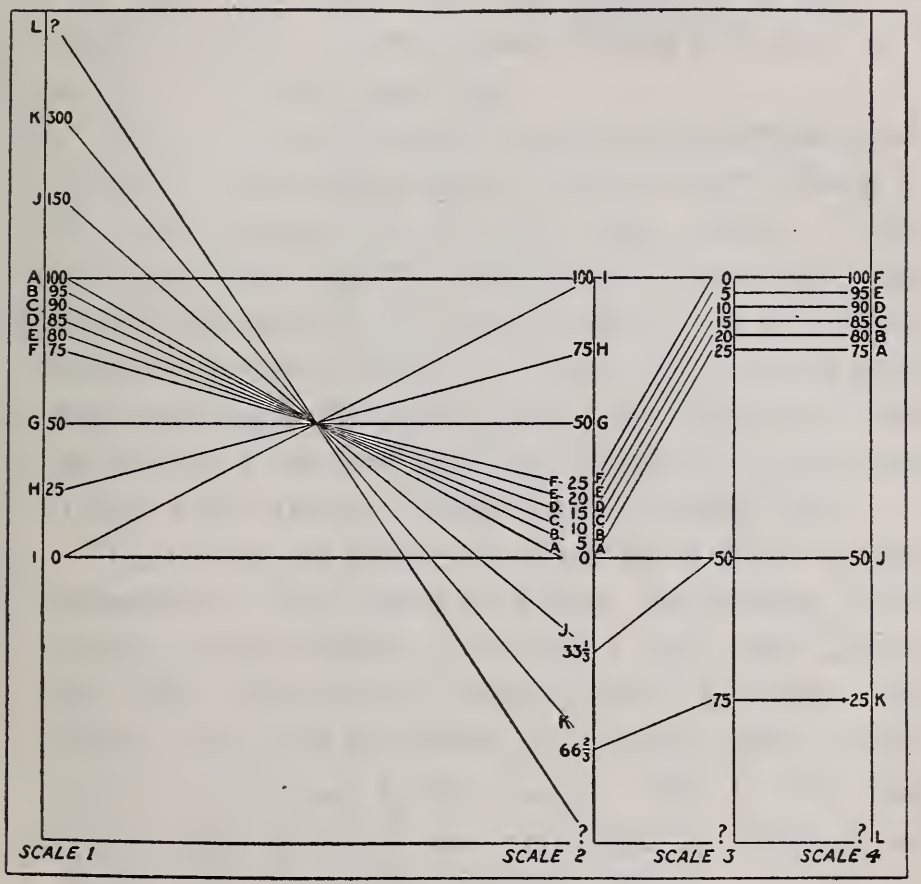


FIGURE 3

This Diagram Illustrates the Principle of Figuring Profit and Loss on the Selling Price.

the same as the Selling Price or below—discounted or marked down. The per cent to sale which this cost represents will depend upon the per cent of gross profit made in selling the article, or upon the per cent below cost at which it is sold, as shown by the per cent scale (Scale 2 A to I or J to L, as the case may be).

Bear in mind that, as the per cent of gross profit (Scale 2) decreases, the per cent of cost (Scale 1) to sale increases on the per cent scale. If the gross profit is entirely eliminated (Scale 2 A), the article being sold at cost, the per cent of cost to sale will go up to 100% (Scale 1 A), the cost price and sale price being the same; but the Sale Price to Selling Price will be 75% (Scale 4 A), the loss (Sale Price below Selling Price) being 25%.

Therefore, at whatever price the article is sold, whether at cost, above or below, the Selling Price (the price at which you should sell) will always be 100%; but do not confuse this with the Sale Price (the price at which you actually sell), which may or may not be the same; that is, the Sale Price may or may not represent a discount or mark-down from the Selling Price.

Selling Above Cost

Apply the diagram (Figure 3) to the following:

An article represented as costing $3 sells for $4—a gross profit of $1 or 25%. This means that 33⅓% was added to cost ($3) to produce the selling price ($4) or a gross profit of 25%. The gross profit ($1) divided by the selling price ($4) equals 25%. Hence the gross profit of $1 equals 25%.

If the same article costing $3 is sold for $6, there will be a gross profit of $3 or 50%, which means that 100% was added to cost.

Thus it will be seen that, when the selling price was $4, the gross profit was 25% and the cost 75% of the selling price, whereas, fixing the selling price at $6 produces a gross profit of 50% (Scale 2 G) and runs the cost down the scale to 50% (Scale 1 G).

It will be noted therefore that the higher the gross profit in per cent, the lower the cost in per cent in the scale between the lines A and I, Scale 1.

Looking at this in the opposite light: If the article costing $3 should be sold for $3.50, the gross profit would be only $0.50 or 14 2/7%. This would bring the cost up to 85 5/7% (Scale 1—between lines D and F).

If the same article costing $3 is sold for $3, it eliminates the gross profit and brings the cost up to 100% (Scale 1 A).

Here it will be noted that, insofar as the cost of the article is concerned, the seller is coming out even; he is selling it at the price he paid for it, but he is losing what it costs him to do business or, in other words, the gross profit necessary to cover the operating and other expenses; hence he is selling at a direct money loss.

Selling Below Cost

Again, if the regular selling price of the article costing $3 is fixed at $4, as above, but it is sold for $2, the sale below cost will be $1, and the discount will be 50% (Scale 3 J), looking at the matter in the light of ledger debit and credit, or of figuring profit and loss on the selling price, as we should. In this case the Sale Price to Selling Price will be 50% (Scale 4 J).

In other words, in selling the article at $2 instead of at the marked-up price of $4, you allow a discount of $2—$1 representing the gross profit of 25% (sale over cost) which you should have made and $1 (33⅓%) the discount from cost price. This discount is 50%—$2 (discount) divided by $4 (the established selling price). That is, in the light of cost keeping, sales would be credited for $4 and debited (thru Loss and Gain)

for $2. At least, profits would be reduced regardless of the method—this or deducting from merchandise—marked down.

If the article is sold for $1, the discount will be 75%—$2 below cost plus the gross profit of $1 (Scale 3 K).

If the article is sold at a fraction of one dollar—fifty cents, twenty-five cents, ten cents—the discount will be almost, but not quite, 100%, that is, taking the selling price as the basis. In other words, 100% discount or loss in selling is not possible. The discount or loss may approach 100% within a fraction, but it cannot reach it.

Cost to Sale

Between lines A and I—Scale 1, the Cost to Sale will vary according to the per cent of gross profit made in selling.

If the established selling price provides for a gross profit of, say, 25% (Scale 2 F) and the article is marked down to sell at cost (Scale 2 A), the elimination of the 25% gross profit runs the Cost to Sale up the scale from 75% to 100%—⅓ or 33⅓%, the loss on selling price being 25% and the sale price to selling price being 75%—Follow line "A" from left to right across the four scales.

Again, if the article is marked down to sell at 33⅓% below cost (Scale 2 J), the Cost to Sale will go up the scale to 150%, the loss on selling price being 50% and the sale price to selling price being 50%—Follow line "J" across the four scales.

If the article is marked down to sell at 66⅔% below cost (Scale 2 K), the Cost to Sale will go up the scale to 300%, the loss on selling price being 75% and the sale price to selling price being 25%—Follow line "K" across the four scales.

And so on down to the lowest point at which the article can be sold and regarded as a sale. If you give the article away, you treat the gift as a sale (100%) and charge the amount to an appropriate expense account.

One Hundred Per Cent Not Possible

In the sale of property of any kind in the regular course of business, it is not possible to make a gross profit of 100% unless the article was given to the seller, and this would hardly be in the "regular course"; neither is it possible to lose 100% in *selling* below cost, the arithmetics to the contrary notwithstanding. To lose 100% one would have to give the article away and eliminate it from sale, which is not done.

When a person makes the statement that he made 200% on a certain deal, he confesses that he does not know how to figure profit. It is true that one may add several hundred or even several thousand per cent to the cost of an article to produce a certain per cent of gross profit on sale, but no amount added to cost will produce 100% gross profit; since, if there is the slightest fraction of 1% cost, the gross profit cannot exceed the difference between this and 100%—the selling price.

Correspondingly, one cannot lose 100% in *selling* below cost, however closely he may approach it.

It is in the selling we make or lose. Hence, it is on the selling price we figure profit and loss.

Selling at a Discount

At whatever price the article is sold below the established Selling Price it is sold at a discount, which means at a reduction of profit. Selling at a reduction of profit does not mean necessarily below Cost, but below Selling Price, and the lower the article is sold below the established selling price, the greater the reduction of profit.

Selling at a Loss

When we fail to make a gross profit, as in selling at cost, we lose the expense incurred in doing business.

When we sell below cost we lose on the purchase price as well, the sum of the two representing our loss, net profit as shown by the selling price not considered.

It is important to know whether an article is being sold above, at or below cost in order to know the per cent of gross profit or loss. An article may be sold at a gross profit and yet at a loss, as above stated, as where the sale price is below the established selling price (Study Figure 3).

Selling on an Even Basis, at a Profit or at a Loss

You sell on an even basis when you sell at the total cost of doing business plus the interest on your investment.

You sell at a net profit when you sell *above* the total cost of doing business plus the interest on your investment.

You sell at a loss when you sell *below* the total cost of doing business plus the interest on your investment.

In selling at a discount, you may be selling at a net profit, at a loss or on an even basis.

You may sell certain articles at a net profit and still do business at a loss; or you may sell certain articles at a loss and still do business at a net profit.

XIV

Deviating From the Established Selling Price

Selling Price Defined

The established Selling Price is the price fixed by the seller upon the article which he sells at the time of putting it into stock. This is also known as the Marked-Up price.

We use the word *selling* in this sense, as distinguished from the word *sale,* in connection with the price at which the article is actually sold, which may or may not be the Selling Price. The Selling Price, therefore, is the price at which the article should be sold as the result of correct figuring, or, in other words, the Marked-Up Price. The Sale Price, on the other hand, is the price at which the article is actually sold. This may be the same as the Selling or Marked-Up Price or it may be lower or higher, depending upon conditions; that is, it may be marked down to sell at a lower price or it may be marked up to sell at a higher price, depending upon the selling qualities of the article and the market price.

The Selling Price may or may not be the result of correct figuring. Too often it is the result of incorrect figuring or of no figuring at all—fixed arbitrarily or by guess or by custom or by competition. Of course, a certain article or all articles may be marked up arbitrarily (according to their selling qualities) if it is known at the time that the marked-up price represents a *sufficient* gross profit, or that the total sales will represent a sufficient *average* gross profit. But you can be sure of this only by keeping a correct book record of sales and verifying your figures weekly and monthly.

The Reasons and the Results

Expenses Estimated

Few persons engaged in merchandising or manufacturing figure their expenses correctly. A large per cent of them, in fact, have no means of arriving at correct figures, because of the crude way in which they keep their books. An outsider would be surprised at the number of merchants, especially, who, arbitrarily, add 5% to 10% to the purchase price to cover the carrying expenses instead of the actual outlay for this service. They want to be on the safe side; but too often, un-

fortunately, this puts them on the losing side. They defeat their own ends.

And in a similar (arbitrary) way they figure that a certain per cent *should* cover their selling expenses. Few include their own salary and still fewer interest on investment or many other items of expense or charge, including breakage, waste, spoilage, etc.

The Basis is Wrong

They do not therefore have a correct basis for establishing the selling price. The price they fix may be on the mark, above or below—as they happen to strike it. If above, they may lose trade; if below, they may lose money on every sale they make, or, at best, come out even on the average and get out of their business a mere living, whereas correct figuring would enable them to make a reasonable profit.

Of course, if the business man is skilled in the technical side of his business, he will know at the time of buying the goods about the price at which they will sell and he will mark-up accordingly. But he must know the gross profit which this marked-up price represents nevertheless.

The Price is Fixed for Them

As a matter of fact, the selling price is often

fixed by the manufacturer or wholesaler of whom the merchant buys or by state law. That is, the price made to the merchant is usually such as to admit of a gross profit of 10% to 40% or more, depending upon the price at which the article is usually sold. This is especially true of controlled or advertised goods, and of school books in states where the sale price is regulated by law.

Method of Figuring Wrong

But, granting that a certain per cent of gross profit may be reasonable, the merchant makes a mistake when he adds this per cent to cost instead of the *equivalent*. He forgets that profit should be figured on sale, not on cost, and, as a result, he merely comes out even or perhaps runs behind.

And he makes another mistake when he fails to mark down when he finds that certain goods will not sell readily at the marked-up price. He also makes a mistake in not marking up when the prices at which the goods can be duplicated go up.

Sliding Scale Price

It is surprising how many merchants in certain lines even today fix what may be called a sliding scale price. They fix the price high enough to enable them to come down and thus lead the customer to think that he is getting a special

bargain—and at that he may be paying more or less than some one else. The practice is bad—unsafe, unbusinesslike.

If the price fixed by the merchant is the result of correct figuring, based upon the *selling qualities* of the article, he will not need to come down. Ninety-nine out of every hundred people feel better satisfied if they know they are paying the price others pay; and, if the price is right, they will seldom go elsewhere. Of course, some buyers make a practice of "looking around", so to speak; but, if the prices are established on a correct basis, the sales will increase rather than decrease.

Special Discounts for Special Reasons

In some businesses all of the time and in all businesses some of the time deviation from the selling price is necessary in certain specific cases and for certain specific reasons; as, for example:

1. Where a merchant sees fit to allow ministers or teachers a special discount of 5% to 10%, which may or may not be good business; or

2. Where most merchants allow a special discount of 5% to 20% to employees; or

3. Where a reduction (mark-down) in the price of certain articles is made to correct mistakes in

buying or to move a surplus or an out-of-season stock or to meet falling prices; or

4. Where certain specific articles are marked down to attract trade—for advertising purposes, which, if rightly handled, may be good business; yet, in most lines of trade, there is usually a sufficient unsalable or surplus stock which can be used for this purpose.

The Merchant Knows What He is Doing

In all of the above cases the merchant knows or should know what he is doing and what he is doing it for. If the selling and the sale prices are the result of correct figuring, he will know not only the reason, but the effect. He will know whether he is sacrificing simply his net profit or nominal net profit or part or all of the gross profit necessary to cover the expense of doing business. In other words, he will know the per cent of discount or mark-down and the effect it will have on his business—how much it will reduce or increase his sales and net profit for the year.

The discounts and mark-downs referred to above should be kept track of in a book kept for this purpose and deducted from the marked-up mer-

chandise price, having been previously taken into consideration in figuring the expense to sale or in establishing the selling price. Such discounts and mark-downs increase the per cent of expense to sale (reduce gross profit) and must be taken into consideration in ascertaining the per cent of gross profit necessary to make on sale in establishing the selling price.

In other words, where an established selling price is fixed as a result of correct figuring, any discount or mark-down from this price either increases the expense volume or reduces the sales volume and, in either case, increases the expense per cent to sale—decreases the profit.

One Price Wins

While discounts may be necessary sometimes, yet, in most cases where allowed by retail merchants in rural towns especially, they are not; and, directly or indirectly, they are detrimental to the interests of the business, particularly when indiscriminately allowed.

The government shows no favors in the payment of taxes; neither do steam or electric railways in the payment of fares, and yet business goes on and people travel just the same.

Merchants can hold to the same fast rule if they figure correctly, and their sales will increase rather than decrease. They will gain two customers to every one they lose.

The "big" merchants in large cities hold to this rule (They would not be big if they did not), and why should not small merchants do the same? It is simply a matter of correct figuring and correct account-keeping — doing business on a business basis.

Under "Special Discounts for Special Reasons" preceding, number 2 is a legitimate discount; number 3 also at times, but good judgment in buying and close attention to turning stock will reduce this to the minimum.

XV

Some Eye-Openers

25% Added to Cost Does Not Mean 25% Gross Profit

If you think for a minute that 25% added to cost means 25% gross profit, test your theory on the following:

A has a city lot to sell. He offers it to you for $400. A friend of yours tells you that he can get you a buyer at $500 (25% added to cost) if you will pay him 20%. That looks good to you; it will net you 5%(?) and so you buy the lot. Your friend sells the lot for $500, deducts his commission of 20% and turns over to you—how much? Exactly $400. Where is your 5%? It doesn't work when put to a practical test, does it? And yet this is the test we are up against in business every day.

Your friend is not charging you for buying the lot, but for *selling* the lot. His commission is based on the selling price and it is on this basis you must pay him in equity and in law.

In the above example, you buy the lot for $400, add 25% ($100) to the purchase price and, on the

assumption that you will make 25% gross profit, as looks reasonable in theory, you offer your friend 20% for selling the lot, feeling satisfied with 5% as your share; but you discover your mistake after it is too late, after you have lost out, as hundreds and even thousands do and must if they persist in figuring profit on cost.

You add to cost a certain per cent with a view to increasing it to a selling price that will produce the per cent of gross profit you desire to make; but do not forget that the per cent you add must be a larger per cent than the per cent of gross profit you wish to make; in other words, that a certain per cent added to a smaller number (cost) is not the same per cent of a larger number (sale).

The Same Amount Added to Different Costs Will Not Produce the Same Profit

So, also, if you think that adding an amount definite to different costs will produce the same per cent of profit, as so many do, test your theory on the following:

A grocer buys eggs at 16 cents a dozen and sells them at 20 cents. He adds 4 cents to cost and makes a gross profit of 20%.

At a later period he buys eggs at 18 cents and

sells them at 22 cents. He adds 4 cents to cost, as before, but makes a gross profit of only 18 2/11%.

At still a later period he buys eggs at 28 cents and sells them at 32 cents. He adds 4 cents to cost, as before, but makes a gross profit of only 12½%.

And yet merchants are doing this very thing day in and day out. 4 cents on a dozen eggs is 4 cents, regardless of the cost price, but that sort of figuring would soon drive a person out of business.

In the first example, the gross profit is fair, it will probably cover the expense of doing business.

But, in the third example, the merchant is certainly losing money. On the same basis of doing business, what will be his gross profit when eggs are selling at 50 cents a dozen, present-day prices? Assuming that he buys them at 45 cents, thus gaining 5 cents, his profit is only 10%—less than it costs him to do business.

Eggs selling at 50 cents should be purchased at not to exceed 40 cents to come out about even; whereas, to make a net profit, the sale price must be higher or the purchase price lower—on the supposition of course that the expense to sale is 20%—it may be more or less.

And what is true of eggs is true of butter and

everything else the selling price of which is fixed by adding to cost an *amount* definite rather than a *per cent* definite. Four cents or five cents or ten cents may look good and yet be far short of the required gross profit.

In each of the three examples above, add 25%, instead of 4 cents, and the gross profit will be, uniformly, 20%, as in the first example.

It may be necessary to sell eggs at an insufficient gross profit, even at a loss, but the merchant should know what he is doing; he should sell with his eyes open, and what he loses in this way should be kept track of in an appropriate expense account or record and not overlooked in the analysis of the day's or month's or year's business. It should be so kept as to stand out prominently on the sales sheet at the close of each day's and week's and month's and year's business.

Profit is measured by per cent, not by dollars and cents. The idea of adding an *amount* definite rather than a *per cent* definite to cost with a view to fixing a selling price that will yield a satisfactory net profit is wrong—it is deceiving.

It is not necessary, of course, in marking goods for sale, to figure the per cent of gross profit to a fraction. Life is too short. But it is necessary to see in your mind's eye that the price you pro-

pose to mark represents a *satisfactory* gross profit; and weekly and monthly, if not daily, the *average* gross profit should be figured to a fraction and compared with the per cent of expense to sale.

XVI

The Two-and-Three-for-a-Quarter Idea

Wrong on the Face of It

Not least among the many practices of retail merchants which reduce their profits is that of selling ten-cent articles in quantities of three for a quarter and fifteen-cent articles in quantities of two for a quarter or three for thirty-five cents. While some merchants have come to see the folly of this, the practice is still very general.

The idea of the merchant is that it will increase the volume of his sales and that this increased volume will more than offset the reduction in price per unit or article in comparing expense to sale. But the idea is wrong on the face of it. The merchants who practice this have, as a rule, a regularly established and possibly slowly increasing trade and the articles sold in this way are usually staple and of such a nature that their consumption is uniform—so much a day or a week or a month, as the case may be.

It Does Not Increase Trade

For example, in the grocery business, if a certain article is consumed by a certain family at the rate of one a day or one a week or one a month, and three are purchased at one time, it means that the article will be called for only once in three days or three weeks or three months, as the case may be. As a rule, there will not be a greater consumption because of the quantity reduction in price; and, since the article is staple and sold at this quantity price as a matter of course and by all merchants in the town alike, no more customers are attracted to the store and the visits of the regular customers are made less frequent, whereas the aim of the merchant should be to get his regular customers to come as often as possible and to attract as many more as he can thru the added life of the store.

How Trade May be Increased

If the merchant wishes to increase his volume of sales, and his profits accordingly, he should offer something special (surplus or unsalable stock, and this *straight*) to attract others than his regular customers and change the specialty before the novelty wears off; and it goes without

saying that such sales should have ample publicity of the right sort—nothing is better than newspaper advertising if skillfully used.

It is a Money Loser

The idea of selling two or three articles for a quarter has not one redeeming feature. On the contrary, it is a money loser from beginning to end. Not only does it sell no more goods to a regularly established trade, but it results in a money loss on every sale made.

If the total expenses and charges incident to the business are, say, 20%, and they are in proportion to sales, and the net profit desired is, say, 5%, an article costing 7½ cents and selling for 10 cents will yield a gross profit of the sum of 20% and 5% or 25%.

This is good business and why spoil it by selling three for a quarter at a gross profit of only 10%, half what it costs you to do business—if, as above stated, your expenses are in proportion to sales?

It Will Not Work in Practice

The merchant holds that trebling the volume of each sale reduces his expenses and yields him a

larger volume of net profit in the aggregate. This looks well in theory, but it will not work out in practice. If the larger volume of sales reduces his expenses it is because his expenses are too high for the smaller volume; and, instead of increasing his sales at a sacrifice of profit, he should reduce his expenses to a point in proportion to his sales and hold to a normal gross profit and sell straight; then he may boost his sales, increasing his expenses in the same ratio, and he will make money.

But are his sales larger because of selling three for a quarter? If any difference, they will be smaller. Keep track of your sales and see how many more customers you will draw because of this practice. If you can afford to sell three ten-cent articles for a quarter, ten cents is too high for one—to get business, unless three for a quarter is your established basis, as in the case of articles sold in sets or groups of three or more.

The author saw advertised in a store recently a certain article at 15 cents or "three for 35 cents". If 35 cents represented a satisfactory net profit (?), how much more business the merchant would do if he offered it at 12 cents straight, the article in question not being one the selling basis of which would naturally be three for 35 cents.

Many persons would buy one who could not use three.

Do a Little Figuring

The idea of selling two or three for a quarter with a view to increasing profit is wrong. No clerk can sell three articles in the same time he can sell one. More time is necessary for the handling and more paper and twine are necessary, as a rule, for wrapping, and the increased time means increased overhead in other items of expense as well.

On the assumption that it will take a clerk two minutes to receive an order for one ten-cent article, wrap it, make the change, etc., it will take a longer time to make a sale of three articles of the same kind.

But, assuming, for the sake of argument, that it can be done in the same time, let us figure: An article costing the merchant 7½ cents sells for 10 cents, yielding a gross profit, as above stated, of 25%—20% to cover expenses and 5% net. Now, the same clerk sells three articles for a quarter to the same customer (total cost 22½ cents; sale price 25 cents; gross profit 2½ cents) at a gross profit of 10% — half what it costs

to do business if the expenses are 20% to sale and the proportion of the one to the other is correct. It is understood that the clerk is working to his fullest capacity in selling straight.

It is a Human Impossibility

Now, can the same clerk, consistent with good salesmanship, make two to three times as many sales on a basis of three for a quarter as he could in selling straight? Do not forget that two to three times as many customers must be served (otherwise the clerk will be idle one-third to two-thirds of the time), since the person buying three for a quarter will buy less frequently, consuming, approximately, the same quantity he would if he bought straight. It is a human impossibility. Doubling or trebling sales means a proportionate increase of expense in store capacity, store furnishings, shelf space, paper, twine, heat, light, clerical service, freight, express and cartage-in, insurance, taxes, interest on investment (for a larger stock must be carried), etc., etc.

It Spells Ruin

The merchant may put it down as a settled fact that, if his expenses are down to a point where

they ought to be—in proportion to sales, and they amount to, say, 20% of sales, and he sells, at a gross profit of 20%, he may run his sales into the millions and he will be no better off than when he began if as well. On the other hand, if his gross profit is below 20%, as in selling three for a quarter, he will lose money on every sale he makes and it will be only a question of time when his surplus capital will have been used, his stock reduced and, after paying his obligations, he will be without a cent.

Of course, all who sell certain articles on a basis of three for a quarter may not sell a sufficient quantity to cripple their business. They may sell certain other articles at a sufficiently high profit to make up. But neither practice is good business; it is not the way to draw trade; it is not the way to increase sales; it is not the way to make money. It may hold a customer in certain lines, but lose him and others in certain other lines.

Some Articles Must be Sold at a Loss

It is well known to merchants, of course, that certain articles, by reason of market and other conditions, must of necessity, at least at times, be sold at a loss, but this loss must be carried by

certain other articles—good sellers. Such sales, however, should be the exception, not the rule, and this exception should be taken into consideration in determining the per cent of expense to sale; at least, the average gross profit must equal the expenses, deductions and mark-downs and a reasonable net profit besides.

A Retail Business Which is Being Discussed

Bear in mind that it is a retail business which is being discussed here. Of course, a manufacturing or a wholesale or a jobbing business may be discussed from a similar point of view, the expenses to be in proportion to volume. That is, the volume of sales and the expense to this volume must be taken into consideration. The per cent of profit on each dollar's worth of goods sold may not be the same as in a retail business, or as in any other business of a different nature, but it must be sufficient to bring the volume up to a point in proportion to sales.

XVII

Net Profit the Same Whether the Town or the Business be Large or Small

The Impression is Wrong

The impression seems to be very general that merchants and manufacturers in small towns can sell more cheaply than those in large towns or cities; or that, in selling at the same price, they can make more money, by reason of the fact that their expenses are less—rent, clerk hire, etc. But this impression is wrong. It may seem logical in theory, but it will not work out in practice.

The impression seems to come from the fact that expenses in the aggregate in small towns are less than the expenses in the aggregate in large towns or cities, which is true, but the fact must not be lost sight of that sales in the aggregate are also less.

The Proportion the Same

The investment, expenses and sales in a small town bear the same relative proportion to those

in a large town or city, and hence the net profit on each dollar's worth of goods sold should and will be approximately the same under *like* methods and conditions.

In other words, a business in a small town with a capital of $5000, expenses $4000 and sales $20,000 will yield the same profit, relatively speaking, as a business in a large town or city with the same capital, expenses and sales. Such a business in a large city will be in a location where the expenses will be about the same as those of the business in a small town; or, if comparison of a business in a small town be made with a like business in a corresponding location in a large town, it must be on a basis of sales, not on an equal basis.

In other words, again, a merchant in a small town must be compared with one doing the same volume of business in a large town, if the comparison is to be made on an equal basis, and not with one doing ten to two hundred times the volume, unless the comparison be made on a percentage basis. If this were not true, merchants in the large towns would move to the small towns, whereas the tendency seems to be the other way, not because the expenses are greater or less, but because of the greater opportunity for growth and expansion — for larger sales in a more densely

populated center. The per cent of net profit may be the same, but the volume of net profit will go up with the sales.

Sales in Proportion to Expenses

In substantiation of the contention so many make that the merchant in the small town can out-sell the merchant in the large town, they cite the enormous expenses of the merchant in the large town, forgetting that the sales are in proportion to the expenses and that the opportunity for buying (direct) at a closer figure increases with the sales.

Of course, if the expenses of the merchant in the large town were double those of the merchant in the small town and the sales no higher, it would be only a question of months until his capital would be used and he would find himself in the bankruptcy court.

Regardless of the town in which a business is located, the capital, expenses and sales must be in proportion in order to yield the net profit to which every business man is entitled.

The selling price is regulated in most lines by competition or by supply and demand, therefore prime cost must be in proportion to the selling price. If below standard by reason of volume, it

increases the profit; if above standard, it decreases the profit—on the supposition, of course, that the selling price is the result of correct figuring.

Expenses May be Too High or Too Low

So, also, expenses must be in proportion to sales volume. If expenses are too high for the volume of business, it means the cutting down or cutting out of net profit, if not indeed doing business at a loss. If expenses are below standard, it means the increasing of net profit, provided the sales are not decreased as a result.

It is possible to increase the expenses of a business recklessly, unnecessarily, unwisely; but, while this is true, there is a certain point below which it is not safe to go without the risk of lessening the sales and the net profit accordingly. Cutting down expenses, in other words, may be in the line of good business or bad business.

When the selling price is fixed by economic conditions, attention must be centered on the prime cost and expenses in order to make a reasonable net profit possible. Of course, equally important is attention to the turning of stock and to collections, while, if a selling price below a reasonable retail standard is fixed for the purpose of in-

creasing the volume, the methods of the mail order house must be applied in buying and in selling if the same net profit or more is to be realized, which is impossible in most retail businesses, there not being the same opportunity for increasing the sales.

The Change is Good Business

The question may be asked, Why is it that merchants in large cities so often move from the so-called heart of the city to points outside? It is because of land values—to save the difference in rent or in interest on investment. They figure that they can draw as large a volume of trade in the less expensive as in the more expensive location, and, if they can, the change is good business. The less expensive location gives them room for expansion at an expense within the volume of their sales. As a rule, people will not object to going a few blocks to get what they want at a price they want to pay.

In a densely populated city or community, however, the business center is not confined to one corner or to one street or to one block, though certain lines of business may be and usually are.

And what is true of a business in a small town

contrasted with a similar business in a large town is also true of a small business contrasted with a large business of the same kind in the same town, whether small or large. The relative proportion of expense to sale will or should be about the same.

Expenses Should Increase Sales

Every business, wherever located, should be worked to the highest point its expenses will bear. In other words, the expenses should increase the sales and, whenever an item of expense will mean increased sales, it should be incurred; that is good business, since the larger the sales the larger the volume of net profit, if the articles are sold at a price that will yield a net profit—if the expenses are in proportion to sales.

XVIII

Good Buying a Factor in Net Profit

First

There are perhaps more good salesmen than good buyers. A person may be a good salesman without possessing the qualities which make for good buying, but the reverse is not necessarily true. A person cannot be a good buyer without knowing the *selling qualities* of what he buys, the selling capacity of his business and the likes and dislikes of his customers. If he buys an article which will not sell at a reasonable net profit, or in a larger volume than can be sold promptly (except in an abnormally rising market, as during the past two years), or city goods for country trade, or country goods for city trade, he is not a good buyer.

Regardless of the size of the town in which the business is located, the customers and probable customers must be considered. A business may cater to a certain class of trade or to all classes, but this must be taken into consideration in buying.

All customers like to have something out of the ordinary for their money, and, if the buyer can

meet their tastes and keep within the price they can pay, he will increase the volume of net profit, if not indeed the per cent as well.

Good taste, as well as good judgment, is a quality necessary to good buying.

Second

Again, it does make a difference where we buy and as to the quantity in which we buy. It does make a difference whether we buy direct—from the producer or manufacturer, as the case may be—or thru middlemen; and, in either case, quantity counts. The small buyer cannot hope to get the same price that large buyers get. This does not mean that the seller eliminates net profit for the sake of increasing his sales, as do retail merchants who sell two and three for a quarter. It does mean, of course, that there is not a uniform per cent of gross profit on all sales; but the lowest is, or should be, satisfactory from the viewpoint of the seller and the highest reasonable from the viewpoint of the buyer, quantity considered, and the average about what it should be from the viewpoint of good business and investment. Wholesaling and retailing are two different propositions.

There Must be a Net Profit—As stated in a previous chapter, if the sales represent a net profit, however small, an increase in volume means an increase in the volume of net profit. But, if net profit is wholly eliminated, the sales may be doubled and trebled and the business will be no better off. It may hold its own, but it will make no money. If the increasing sales call for additional capital, the investors must put it up, which will mean a reduction in the rate of interest on investment.

There is a Difference—The practice of producers, manufacturers, wholesalers and jobbers to quote prices on a basis of volume, which they may, within certain limits, be able to do with safety, leads small dealers who buy of them to think they can do the same, forgetting that those of whom they buy practically fix for them the selling price and at a figure below which they cannot, ordinarily, go without losing money; and forgetting, further, that there is a difference between manufacturing or wholesaling and retailing.

Not all manufacturers or wholesalers, of course, have a sliding or volume scale of prices. Some hold to one price regardless of the volume in which sales are made. They may cater to a particular class or to the general trade, but they make one price to all.

XIX

The Per Cent to Add to Cost to Get the Per Cent of Profit Desired

Assuming that you know the average gross profit you must make on total sales, and that your practice is to mark up on a basis of gross profit rather than on that of the selling qualities of the goods you buy, how will you mark the articles to produce that profit? In other words, what per cent added to cost will produce the gross profit you desire to make?

For example, if an article costing, say, $2.80 is to yield you a gross profit of, say, 30%, at what price will you sell it? What per cent will you add to cost? How are you to know in the case of each article you mark what per cent to add to cost to produce the desired profit?

The selling price is always 100%. Subtract from this the per cent of gross profit you desire to make and you will have the cost in per cent. In the preceding example, 70% (100%—30%) equals $2.80. Therefore, 1% equals 1/70 of $2.80 or $0.04 and 100% (the selling price) equals 100 times $0.04 or $4.00, the price at which the article

must be sold to yield a profit of 30%. Proof: 30% of $4.00 is $1.20. $4.00—$1.20=$2.80, the cost.

This is the result by analysis, but the process is too long. A quicker and a better way would be to take the desired profit (in this case 30%) as the numerator and the cost (in this case 70%, which is 100% minus the gross profit, 30%) as the denominator and reduce the fraction to its lowest terms and increase the cost by this result.

Still another way (same principle) is to use equivalents. For example, 30% gross profit is equivalent to 30/100 or 3/10 and the fraction to add to cost to produce this is 3/7 (7 being the denominator of 3/10 minus the numerator). In other words, reduce the per cent of the gross profit desired to a common fraction, subtract the numerator (which is to be retained as the numerator of the new fraction) from the denominator and the result will be the denominator of the fraction by which the cost must be increased.

For example, to make ⅓ (33⅓%) on sale, add ½ (3—1=2) to cost; to make ¼ on sale, add ⅓ (4—1=3) to cost, and so on. Regardless of the fraction representing the profit you desire to make, subtract the numerator from the denominator and you will have the denominator of the fraction to

add to the cost or by which the cost must be increased. In business, the gross profits commonly made (sale over prime cost, deductions not included) are 1/5, 1/4, 1/3 and 1/2. From these subtract the numerator (1) from the denominator (5-4-3-2 respectively) and you will have the denominator of the fraction to add to cost or by which cost must be increased—1/4, 1/3, 1/2 and 1/1 respectively.

Another way, and a very simple one too, is to divide the cost by the cost per cent expressed decimally; as, $2.80 (cost) divided by .70 (cost per cent expressed decimally) equals $4.00, the selling price. Any cost price divided by the cost per cent, which is 100% minus the gross profit desired, will give the selling price.

The 30% gross profit mentioned above is the *average* on *total* sales. Not all articles you sell will produce this per cent—some more, some less. You will sell some articles at a gross profit of as low as 20% or less, while certain other articles will yield you a gross profit of 40% or more.

You should therefore know the *selling qualities* of each article you sell and the average gross profit you must make and mark up accordingly. You should anticipate the sales of each department of your business and ascertain in advance

if the average gross profit will be satisfactory. You should also verify your figures weekly and monthly.

For specific methods of figuring and tabulating, see Chapters XXII, XXIII and XXIV.

Per Cent of Profit Known; Per Cent to Cost Unknown

When you wish to know the per cent to add to cost to produce the per cent of gross profit you desire to make, use, as a basis, the following table of equivalents:

To make 5% (1/20 of 100%) on sale add 1/19 to cost.
To make 10% (1/10 of 100%) on sale add 1/9 to cost.
To make 12½% (1/8 of 100%) on sale add 1/7 to cost.
To make 15% (3/20 of 100%) on sale add 3/17 to cost.
To make 16⅔% (1/6 of 100%) on sale add 1/5 to cost.
To make 20% (1/5 of 100%) on sale add 1/4 to cost.
To make 25% (1/4 of 100%) on sale add 1/3 to cost.
To make 28% (7/25 of 100%) on sale add 7/18 to cost.
To make 30% (3/10 of 100%) on sale add 3/7 to cost.
To make 33⅓% (1/3 of 100%) on sale add 1/2 to cost.
To make 35% (7/20 of 100%) on sale add 7/13 to cost.
To make 40% (2/5 of 100%) on sale add 2/3 to cost.
To make 50% (1/2 of 100%) on sale add 1/1 (100%) to cost.
To make 66⅔% (2/3 of 100%) on sale add 2/1 (200%) to cost.

In like manner, the equivalent denominator of any per cent on sale may be gotten by subtracting the numerator (which should be retained as the

numerator of the new fraction) from the denominator—the per cent on sale changed to fractional form.

Per Cent to Cost Known; Per Cent of Profit Unknown

When you wish to know the per cent of gross profit any per cent added to cost will produce, use, as a basis, the following table, which, in principle, is the reverse of the preceding table:

1/19	added to Cost is	1/20 (5%)	on sale.
1/9	added to Cost is	1/10 (10%)	on sale.
1/7	added to Cost is	1/8 (12½%)	on sale.
3/17	added to Cost is	3/20 (15%)	on sale.
1/5	added to Cost is	1/6 (16⅔%)	on sale.
1/4	added to Cost is	1/5 (20%)	on sale.
1/3	added to Cost is	1/4 (25%)	on sale.
7/18	added to Cost is	7/25 (28%)	on sale.
3/7	added to Cost is	3/10 (30%)	on sale.
1/2	added to Cost is	1/3 (33⅓%)	on sale.
7/13	added to Cost is	7/20 (35%)	on sale.
2/3	added to Cost is	2/5 (40%)	on sale.
1/1 (100%)	added to Cost is	1/2 (50%)	on sale.
2/1 (200%)	added to Cost is	2/3 (66⅔%)	on sale.

In like manner, the equivalent denominator of any per cent added to cost may be gotten by adding the numerator (which should be retained as the numerator of the new fraction) to the denominator—the per cent added to cost changed to fractional form.

Only a Few Equivalents Necessary

Since the staple lines of merchandise stock in most businesses may be so divided or departmentized as to yield a fairly uniform gross profit on the sales in each division or department, in buying for or in marking the goods belonging to each division or department the merchant, in order to mark up intelligently, will need to familiarize himself with only a few equivalents (since the marking must be on a basis of the selling qualities of the article), which may be expressed in common or decimal fractional form, as may be preferred.

For example, if 25% gross profit is desired, this may be written in common fractional form, as ¼, or in decimal form, as .25 and the equivalent fraction by which the cost shall be increased may be written as ⅓ or as .33⅓ or .3333. In the case of ⅙, ⅕, ¼, ⅓, ½ and 1/1 the common fractional form as here written will be found the more convenient.

The change from common to decimal fractional form is effected by dividing the numerator by the denominator. The change from decimal to common fractional form is effected by striking out the decimal point or period, drawing a horizontal

line beneath the figures, writing beneath this 100 or 1000, as the case may be, and reducing the fraction to its lowest terms by division.

The merchant who is skilled in marking goods for sale can perform these operations mentally and instantly.

Of course, all goods in any one department do not sell at a uniform per cent of gross profit. If they do, the department manager is not a good salesman, he has not made a careful study of the *selling qualities* of the goods he handles or of the likes and dislikes of his customers. But the per cent of profit on staple articles of a kind or class will be fairly uniform.

XX

Percentage and Price Lot Methods of Figuring Profit on Daily Sales

Mercantile Businesses

Technically speaking, it may be stated that all persons engaged in trading lines are merchants, yet the same methods of figuring profit or of cost keeping will not be found in all trading businesses keeping a cost system.

In businesses commonly known as mercantile, such as clothing, furnishings, dry goods, grocery, hardware, shoe, furniture, drug, fruit, candy, etc., one of two methods may be employed in the keeping of a cost system, namely, Percentage or Price Lot, although these two methods may not work equally well in the businesses mentioned. Both methods are reliable, however, and one or the other may be applied to any mercantile business, whether large or small; and, with slight modification, to any trading business or to any manufacturing business.

Store Organization and Management

From the viewpoint of organization and management, mercantile businesses are Independent, Dependent or Interdependent.

An Independent business or store is one which is devoted to some specific or special line, as groceries, clothing, shoes, etc., independent of any other line or lines. While such businesses are to be found principally in the smaller towns and cities, they are to be found also in the larger towns and cities, frequently on a large scale too, and in larger numbers than any other form of store organization.

The magnitude of an Independent business may be large or small and the proprietorship individual, partnership or corporate.

A Dependent business is one organized as a branch of another business in the same or in a different locality.

An Interdependent business may be said to be a combination of two or more Independent businesses under one roof and management. Such a business is commonly known as a Department Store, although the idea of departmentization is much broader than this. It comprehends not only the grouping of merchandise into distinct lines, but the subgrouping into distinct kinds as well, which enables the management to keep in close touch with the selling qualities of the several lines and kinds of goods carried.

While, from the standpoint of financial control

and management, the several distinct store units which go to make up an interdependent business constitute one store on a large scale; yet, from that of stock investment, expense outlay and earning power, these units are Independent stores, the manager of each being allowed a certain amount of capital with which to run the business, and he is expected to make good.

Departmentization

Whether the business be Independent, Dependent or Interdependent, in order to figure profit intelligently and accurately, a correct record of purchases, sales and gross profit—as well as expenses—must be kept.

The departmentization and subdepartmentization of a business should be governed, in large measure at least, by the magnitude of the business and the number of clerks employed. The larger the business the more minutely it can be departmentized and the more accurately the selling qualities of the stock carried can be traced.

Of course, a business which starts in a small way must and should departmentize and add to its clerical force by degrees. But a high degree of system may be put into practice in a business not large enough to employ even two clerks.

While a large business demands system, a small business is entitled to it and should have it.

In other words, whether the volume of sales be large or small or the business located in the large city or in the smallest rural town, as high a degree of system may be used in an Independent business as in a Dependent or an Interdependent business—if the management understands system and can appreciate its value.

Percentage Method

It is not necessary to explain here what percentage means. It is clear alike to business men, to teachers and to students. But it is necessary to explain how to apply percentage to a selling business or to a producing business.

Methods of Keeping Track of Sales

Cash Register—While in large mercantile businesses there is only one method of keeping track of sales, namely, by means of Sales Tips, in small businesses other means may and of necessity must be employed. A very effective means is the Cash Register if it is of the right kind, if it registers the cash and time sales, and if, further, discounts, mark-downs, stock, etc., are properly kept track of. Keeping track of sales alone is not enough; a simple cost system is necessary.

Sales Slips—A step in advance of the cash register (both may be used) in a business large enough to warrant it (sales, say, of $20,000 and upwards) is the use of small Sales Slips, on which the clerk writes the amount of each sale, and a cashier to take care of these Sales Slips and make the change. When more than one clerk is employed, it is better to have these Slips numbered, so as to keep track of the sales which each clerk makes. The importance of this is obvious.

The person who acts as cashier can, if rightly trained, keep a simple cost system, or at least with a little assistance from the management.

Sales Tips—The ideal way of keeping track of sales, however, where the departmentization and the number of clerks employed warrant it, is by means of Sales Tips, which most merchants at least have seen and understand, and by the use of which the sales of each department are kept by themselves, and the sales of each clerk in each department are known.

Basis for Determining Gross Profit on Sales

Since the stock in a store does not sell at a uniform per cent of gross profit, it is not easy for business men who do not keep a cost system to

determine with any degree of accuracy (and anything short of accuracy is deceiving) the average per cent of gross profit which they make on daily sales.

Some advise departmentizing according to the respective per cents of gross profit made in selling. In other words, they would divide the stock of goods into, say, three to possibly eight departments, depending upon the line or lines carried, and keep track of the sales in each department.

While this may be done, it accomplishes nothing, involves unnecessary work, and leaves the merchant in the dark as to the value of the unsold stock. Why, therefore, substitute something not so good for something better? The methods of large businesses, of successful business men, cannot well be improved upon, except as they themselves improve them thru the necessities of their business and the aid of skilled accountants. And do not think for a minute that what will work in a large business will not work in a small business with slight modification or in principle at least.

Therefore, instead of departmentizing on a basis of per cent of gross profit, keep proper track of merchandise—purchases, sales and inventory. Enter in your stock record (card or book) by departments, if you departmentize, the purchase

and selling prices of every invoice you receive, and see that the selling price represents a satisfactory gross profit. Do not rely wholly upon your judgment as to the selling qualities of the goods you buy.

Keep track of discounts, mark-downs, etc., as they occur.

Keep track of the daily sales—amounts only for this particular purpose; but for the purpose of keeping track of stock a unit record should also be kept, the method depending entirely upon the nature of the business and the system employed.

At the close of each week, bring to a merchandise summary sheet the cost and selling-price footings of all purchases for the week, plus carrying expense, less discounts and mark-downs (from selling price). To these footings should be added the footings at the beginning of the week. Get the per cent of gross profit which the selling price represents—the difference between the cost and selling prices divided by the selling price. This will be the per cent you made on your sales for the week. Total your sales and deduct the gross profit resulting from this per cent. The remainder will be the cost of sales.

The cost and sale footings of the week's sales should now be subtracted from the week's basis

(purchases and previous inventory) and the difference will be the basis for the next week, and so on from week to week.

In brief, this is the proper way of keeping track of sales by the percentage method. And it is so simple as to be applicable to any business, large or small. The time required to keep track of stock in this way will not average twenty minutes a day.

For the actual operations of a week's business, see Chapter XXIV.

It is important of course that you ascertain if the per cent of gross profit on the week's sales is large enough to cover the total expense (merchandise deductions not included) to sale and leave you a net profit of 5% to 10%. Compare the two per cents.

Price Lot Method

By this method one can tell the per cent of profit he makes on every article he sells, and on the total sales for the day, by adding the Gross Profit and the Sale Price columns (Figure 4) and dividing the former by the latter.

This method is especially adapted to furniture, clothing, shoe and similar businesses whose prices are not changing from day to day and whose sales are not uniformly small. It involves slightly more

work than the percentage method, yet any business large enough to warrant the keeping of a person to make change can use it.

The principle is this: On every article received into the business is placed a sales ticket or label on which is written, in addition to the manufacturers' "Lot" number, if the article has one, a "Stock" number, as for example, "Stock No. 101", and the sale price in plain figures, say, $4. The Stock number is the "key" to the cost price. If the article, for example, is a certain hat (Lot No. 486—Stock No. 101—Price $4), in selling this hat the sales clerk will write on the Sales Tip the "Stock" number and the "Sale" price only.

The Stock number should be written on a page of a small book (designated as "Cost Key") and, to the right of this number, the Cost price, say, $3, and, to the right of this, the Selling price, say, $4; as, for example, 101 — $3 — $4. This means that Stock No. 101 cost $3 and sells for $4 and that the sales clerk cannot deviate from this price without the manager's o. k. being on the Sales Tip.

When the Sales Tip for the sale of this hat, or any hat from this Lot number, comes to the cashier's desk she will write in a column of a cheap book which she will keep for the daily sales (Fig-

STOCK NO.	SALE PRICE	COST	GROSS PROFIT	
			AMOUNT	PER CENT
101	4	3	1	25
102	4	2 90	1 10	27 5/10
184	2 50	1 75	75	30
185	3	2	1	33 1/3
	13 50	9 65	3 85	Av. 28 1/2 +

FIGURE 4

Price Lot Method of Figuring Profit.

ure 4) the "Stock" number and, in a column to the right, the "Sale" price and, in a column to the right of this, the "Cost" price, which she gets from the Key thru the Stock number, the Stock number and Sale price only being on the Sales Tip.

The Key contains the stock number and the cost and selling prices of every article in the store and, being in numerical order, the stock numbers will give the cost instantly. The "Hat" division of the cashier's cost record, for example, at the close of the day, will look something like Figure 4.

The per cent column shows the per cent of gross profit on each article sold and the average for the day.

If the expense of doing business and other charges and deductions are, say, 23½%, more or less, the net profit on the day's sales will at once be seen — in this case 5%; 28½%—23½% =5%.

The per cent of gross profit on each sale may or may not be carried out, but that on the total sales for the day should.

By this method, there will be no possibility of figuring the per cent of gross profit on each article sold above or below what it should be. It will be exact. The cost and quantity of the sales and the unsold goods will also be exact—if proper record is kept.

While a specially ruled book is desirable for keeping this record, it is not necessary. Any cheap blank book may be ruled by hand.

The Cost Key (Stock Number) should be in a book or on a sheet convenient for quick reference by the cashier as she copies the sales from the Tips. And, by the way, Sales Tips suitably ruled and printed should be used.

A duplicate of this Key should be kept by the manager in a small vest-pocket book for convenient reference during business hours, but it would better be kept in the safe at night.

The Stock number may begin with, say, 101 and run into the thousands if necessary; that is, for each department, or for the total stock, as may be preferred. Each distinct group of articles of a certain lot or manufacturer's number costing the same price and selling at the same price may be given the same stock number.

Of course, there are many ways of applying this method, the above being only one. A common way is to write on the tab or label, as the stock number, the cost figures in reverse or transposed order, but this is not wise, the cost being too easily deciphered.

Another way is to use letters or symbols, or words represented by figures, but these also are easily deciphered.

Orders should be placed daily or weekly or as often as may be necessary for replenishing stock on a basis of the kind and quantity sold as shown by the "Stock No." column recapitulated on a stock sheet for this purpose.

Manufacturing Businesses

It is comparatively easy to figure profit in a manufacturing business if correct cost records are kept. The method is practically the same as the "Price Lot" method in a mercantile business.

The cost to manufacture each article is known. The cost to sell the article and other charges are also known. The net profit, therefore, depends upon the price at which the article can be sold.

By means of a sales sheet, the sales are entered daily as made—cost and sale prices. The difference between these two sets of figures, which should be taken once a month for ledger and statement purposes, is Gross Profit, which, if divided by the sales will give the per cent. Deduct the Commercial Expenses and Direct Charges and the result will be the Nominal Net Profit. Divide this by the sales and the result will be the per cent.

XXI
The Turning of Investment

What Turnover Means

Turnover is a term much used by merchants and manufacturers, but little understood either as to meaning or value.

While, in itself, the term means nothing to the business man, yet, with certain modifications, it means everything. Indeed it is the pulse of a selling business, and may spell success or failure, depending upon how closely it is watched.

The number of times a business man turns his investment means nothing in itself but when each turnover represents a reasonable net profit and the keeping of every item of stock in the store moving, it spells success.

For example, if a merchant turns his investment of, say, $30,000 once at a gross profit of, say, $6000 (20%—Sales $36,000) it means little or nothing to him, since it represents a gross profit of scarcely enough to meet his expenses; at least, the expenses of most retail businesses will not exceed 20%. But, if he turns his invest-

ment of $30,000 once at a gross profit of $15,000 (33⅓%—Sales $45,000) it will show him that the oftener he turns his investment the more money he will make.

Aside from this, however, turnover means nothing as a yearly result or operation; and, since this is true, what should concern the business man is the weekly per cent and volume of gross and net profit which his sales produce him and the proportion of stock investment to sales, rather than simply the number of times he turns his investment.

They Have the Wrong View of It

It is safe to say that fifty to seventy-five per cent of retail merchants give little or no thought to the study of turnover in the sense in which it is understood and watched by the big merchants, while perhaps ninety per cent of the others do not figure correctly and are as much in the dark as if they did not figure at all. They seem to place more stress upon the number of times they turn a dollar than upon the volume of gross and net profit which the turning of the dollar should represent to them.

The correctness of these statements may be

seen from the fact that, of those who engage in business, only two to four out of every one hundred succeed in the sense in which success is understood and measured. They figure turnover as they figure profit—on the wrong basis if at all.

Capital and Stock Investment Not the Same

At the outset, a distinction must be made, in speaking of investment or of turning investment, between capital investment and stock investment. The terms are not synonymous. Which of these terms is meant when merchants speak of turning "capital" is problematic.

Reference is frequently made to the turning of capital as applied to sales or simply to the relation of capital to sales; whereas, as a matter of fact, capital to sales means nothing to the business man except proportion—the proportion one should bear to the other.

It is not the number of times a merchant turns his capital investment which should concern him, nor the number of times he turns his *stock* investment, for that matter, unless he has in mind, in connection therewith, the per cent and volume of net profit to which his investment and reinvestment entitle him.

Capital investment, as a matter of fact, is frequently a small part of the capital employed in a business. Earnings left in, money borrowed and credit received must be taken into consideration.

The author has in mind a certain business whose actual invested capital is less than $4000, yet its annual sales run over $100,000.

The thing which should concern the business man, therefore, is the turning of his investment in *stock, or merchandise,* as fast as close attention and application to business and a reasonable net profit will enable him to turn it.

Turnover in a Trading Statement

The term turnover as used in a trading or a manufacturing statement means the cost of the goods sold. This divided by the stock investment will give the number of times the investment has been turned. But of what value is it to the business man to know the number of times he has turned his stock if each turnover does not represent a reasonable net profit? A merchant may turn his stock fifty times a year, but if each turnover does not represent a reasonable net profit he will be no better off than if he had not turned it once.

What Stock Investment Means

But, again, what is meant by stock investment? It does not mean, necessarily, the value of the stock at the time of beginning, for, while the stock is replenished as sold, the purchases may be in excess of the cost of sales, thereby increasing the investment, or they may be less, thus decreasing the investment. Nor does it include the investment in buildings, fixtures, expense items, etc., but in stock, or merchandise, as shown by a correct average of the previous inventory and the purchases, regardless of the proportion of cash and credit investment which this average represents.

Attention Should Be Directed to Stock

Taking a concrete illustration, let us assume that A, who is starting in business, invests $5000 as follows: $800 in furniture and fixtures; $200 in items of expense necessary in selling; $3000 in merchandise (cash down), and $1000 in the bank as a surplus to be used if needed while getting started.

Now, his capital investment is $5000 and his stock investment is $3000. While it is important that he take proper care of the store fixtures and watch the expense items and not draw on the

$1000 in the bank unnecessarily, it is to the $3000 invested in merchandise that his attention should be especially directed. He should turn this as often as ability, good salesmanship and close attention to details will enable him to turn it, on the assumption that every dollar's worth of goods he sells represents a reasonable net profit, and that his weekly, monthly and yearly sales reach the point of reasonable proportion to the investment in stock and to the expense of doing business.

He started with a clean slate—a $3000 stock, paid for, $1000 in the bank and $1000 otherwise invested. Now, on the assumption that his sales will average him, say, 30% gross profit, and that he borrows no money, each dollar's worth of goods sold may be tabulated as in Figure 5.

It is assumed here that the carrying expenses are 1% of the sales, that the commercial expenses are 19% of the sales, the total being 20%, and that the nominal net profit desired is 10%—a little high perhaps considering the per cent of expense to sale.

Now, the item or items in the "Prime Cost" column represent a reduction (turning over) of the stock investment and the footing of this column should be reinvested so as to keep the stock

Prime Cost		Gross Profit						Sale Price	
		Expenses							
		Carrying		Commercial		Total			
							Nominal Net Profit		
70		01		19		90	10	1	00

Figure 5

Sales Analysis Chart—Cash Business

Note — This Chart, which Represents a Cash Business, is Intended to Guide the Merchant in Keeping Track of Turnover in the Sense of Replenishing Stock in Proportion to Sales and Watching Profit.

up to the $3000 mark as closely as may be or in proportion to sales; that is, as the stock diminishes, a new supply should be purchased and paid for on a basis of the footing of this column, taking advantage of the discount allowed for cash, due allowance being made for the natural increase of stock due to increased sales, if the sales show an increase, and for "season" and "rising market" purposes, etc.

A Unit and Value Record

In addition to the money value of the stock sold, track must be kept also of the different items or units of stock. It must be known what items are selling and what items are not in order to purchase wisely. If the prime cost of the sales for the day, for example, amounts to $75, it must be known what particular items of the entire stock have been sold before an order can be mailed to replenish the stock, or, in other words, to properly keep track of stock turnover.

An item or unit as well as a per cent and value record should therefore be kept, whether by means of a stock record (card) system or a close watch by the clerks or a tabulation of the daily sales tips. The scheme which will enable the merchant, at

the least expense, to supply the demand of his customers without overstocking or running short is the one to adopt. A merchant cannot afford to overstock, as the net earnings must be sufficient to make the capital investment profitable to the investor.

Replenishing Stock

Whether purchase orders be issued daily or weekly to replenish stock sold will depend entirely upon how the stock is moving and where the purchases are made; but, one thing is sure, it should not be for a larger money value than shown by the "Prime Cost" column (Figure 5) for the time between the periods of ordering, except as warranted by increased sales or a rising market or season conditions, since, when the invoice comes, it must be paid from the money taken in as shown by this column, not as shown by the "Sale Price" column, and this is true whether the sales be on a cash or a credit basis, except that, if on a credit basis, the current cash alone will not or may not meet the invoice payments as they become due—cash basis.

In other words, staple stock should be replenished on a basis of the cost of sales and increased only as warranted by net earnings.

Basis of Expansion

This does not mean of course that a business cannot or should not be run on borrowed capital or that money should not be borrowed for purchasing ahead or for expansion purposes. It means simply that the increase or expansion should be in proportion to or on a basis of net profit. That is, the amount in the "Total" expense column is needed to meet the running expenses of the business and should not be drawn on for any other purpose, while that in the "Nominal Net Profit" column should go towards interest on investment, the payment of dividends and the creating of a surplus fund if not used for expansion purposes.

Increasing the stock to meet increasing sales or to take advantage of a rising market is good business, but overstocking is bad business. Therefore, unless we know what we are doing, unless we are guided by facts and figures, we should not increase stock out of proportion to sales. Placing orders ahead for "season" goods is of course a different proposition. This is good business if the merchant knows what he is doing.

Credit Sales

It is safe to say that, with retail merchants generally, in small towns especially, the credit sales

will run close to 40 to 50 per cent of the total sales. This is a great disadvantage and loss to the merchant. It means that he cannot discount his bills unless he draws on his surplus capital (if he has it to draw on) or borrows the money at the bank (if his credit is good), and, if he allows his customers a longer period of credit than he is allowed, as is so frequently done, even his surplus capital and credit may in time run out. Unrestricted credit has driven many a business to the wall, and the longer the period of credit the greater the chance for loss by failure of the customer to pay. If credit is allowed, it should be upon a reasonable certainty that payment will be made within a reasonable time—that allowed the merchant or less—and that bad accounts shall be reduced to the minimum.

Stock Investment as Applied to Turnover

As previously stated, stock investment does not mean necessarily the investment or inventory at the time of beginning. The purchases must be added to the inventory and from this result a correct average determined; but few persons, by their method of figuring, arrive at a correct average.

PROCEDURE

Assuming that the merchant starts with an in-

ventory of $5000 and that his inventory at the close of the year is $5840, a book inventory not having been kept and a physical inventory or a statement of business not having been taken in the meantime, these two inventories should be added ($10,840) and divided by 2 to get the average ($5420).

But once a year is the small merchant's idea of a statement period. Let us get down to a monthly basis, which does not mean the taking of a physical inventory monthly, but the keeping of a correct merchandise record, and this need involve but little time or expense—not to exceed twenty minutes a day.

Assuming that the inventory at the beginning of the year amounted to $5000, as before, and that the twelve monthly inventories amount to, respectively, $5840, $5460, $5630, $6204, $5910, $5090, $6124, $6215, $5924, $6318, $6004, $6180, the sum of these thirteen inventories will be $75,-899. This result divided by 13 will give the correct monthly average cost or investment for the year.

Proceeding similarly on a weekly basis (the sum of fifty-three cost groups divided by 53) will give a closer and better average for the year and at no more expense to keep.

The average cost of goods, whether it be the result of a yearly, monthly or weekly basis of figuring, divided into the cost of sales (turnover) will give the per cent of turnover or the number of times or fraction of one time that the average stock investment has been turned.

Discounting Bills

Few merchants appreciate the enormous advantage to their business of discounting their bills. One of the largest retail merchants in the country told the author once that if he did not make a cent net profit on his sales, his cash discounts earned would make him rich. If a merchant's sales for the year are as low even as, say, $12,000, the cost of the sales being, say, $9000, even 2% of this item will amount to $180, which is worth saving; and this is net, less the small item of interest on the money employed if it would otherwise draw interest or if borrowed at the bank. Deduct 3%, 5%, 7% and see what the result will be.

Which is the More Profitable

And this brings to mind the question so frequently asked by merchants doing a cash and a credit business, Which is the more profitable, to

borrow money at 6% and discount one's bills at 2% or let them run full time (net) and pay from collections? If the term of credit to the merchant is 30 days and the discount period is 10 days (in each case from the date of the invoice), the money borrowed will be for 20 days (plus); and, if the interest charged be 6% on, say, $100 for 20 days (plus), this would amount to $0.33+, whereas 2% cash discount would amount to $2, a saving of $1.67—. Even at 1%, it pays to borrow the money to discount bills—a saving in this case of $0.67—, while 3% to 7% means a handsome income to the business man independent of net profit on sales.

Figuring Ahead

Important as it is to figure the turning of stock as you go along, as you sell, even more important is it that you figure ahead—in advance of sale.

It is not enough that you look after the business of today, but that you look out for the business of tomorrow, that you ascertain in advance about what your daily, weekly and monthly turnover, or, more properly, gross profit, as a result of turning your stock, will be, taking present figures (cost and sale prices) as a basis.

If the result is disappointing, it is better that you know it in advance than at the end; in other words, at a time when you can apply prevention rather than at a later period when it may be too late even to apply a cure. While the latter is good if applied in time, prevention is better.

If you figure ahead, you will know about how much business you will do in a given time at your present rate of sales, and, if the result is not satisfactory, you will take steps to make it so; you will speed up; you will stop the leaks—you will do one hundred one things you would not do if you waited until the end of the year, as so many do.

You may assume that your merchandise inventory or investment at the beginning of the week amounted to $10,000 and that your purchases during the week amount to $400. Now enter in your merchandise summary record not only the inventory and purchase cost, but also the selling or marked-up price of these two items and the gross profit (amount and per cent).

Does the per cent of gross profit thus extended come up to the per cent you should make on sale, your expense to sale being known? Does it represent the per cent of net profit to which you are entitled? But, granting that it does, the gross profit on your sales may not come up to this per cent.

You may have mark-downs and discounts from the marked-up or selling prices, which will reduce your per cent of gross profit on sales. Therefore you should establish a weekly basis — inventory plus purchases, less discounts, mark-downs, etc.; that is, you should not allow more than a week to pass without knowing what you are making on sales, and not more than a month to pass without taking a complete statement. Yet, think of the number of business men who, thru the keeping of a crude system of single entry bookkeeping, wait until the end of the year to get the result of their operations! They are practically in the dark for a year as to what their business is costing or producing them; and, even then, the result is not fair to the producing power of the business under proper figuring and account keeping.

If a business is worth your time and your money, it is worth a system of figuring and cost keeping that will enable you to keep track of it. A business will prosper in proportion to the thought and effort put into it.

Credit Basis

But Figure 5 and the statements made in relation to the turning of investment imply a cash

business. If credit is given, the turnover will be less frequent by the length of the credit given and the amount.

For example, if you sell $100 worth of goods on one month's time, you will not have turned the cost of this sale until you get your money. From the standpoint of turnover, you have, as it were, simply parted with the possession of the merchandise and, weekly, monthly and yearly, in figuring turnover, you should deduct from the total cost of goods sold the cost of the unpaid sales on that date to get the correct turnover—unless, of course, you figure that the credit sales of one month will average with those of another month and, more particularly, that the accounts are good.

Figure 6 will show the results and workings of a credit business as applied to turning merchandise investment.

The effect of credit sales upon the running of a business will at once be seen. On the assumption that the credit sales are 50% of the total sales, until collections begin to come in, 50% of the "Prime Cost" (less the cash discount) and "Total" expenses must be drawn from surplus or borrowed at the bank to discount the bills and meet the Carrying, Commercial and other expenses, while the Nominal Net Profit will be only

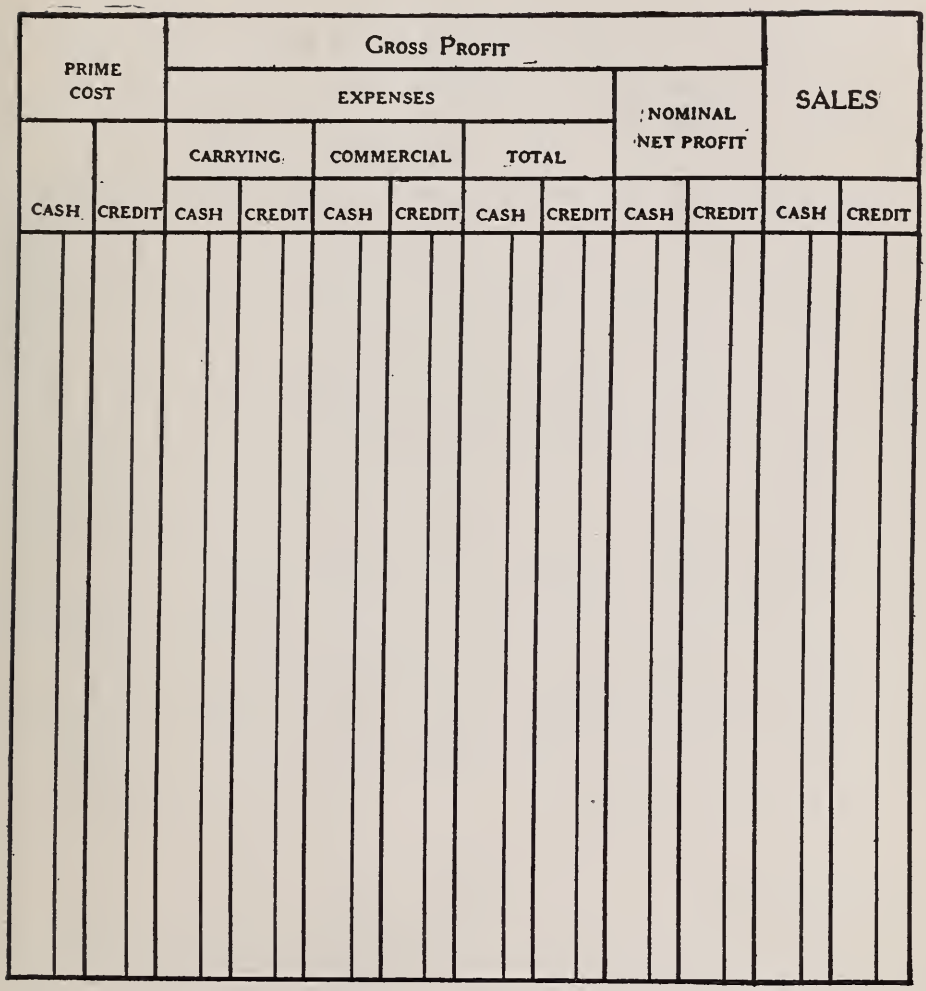


FIGURE 6

SALES ANALYSIS CHART—CREDIT BUSINESS

Note—This Chart Illustrates a Credit Business and is Intended to Guide the Merchant in Issuing Checks for the Payment of Purchases.

50% cash. And, after the collections begin to come in, there will be about the same per cent of credit and there will still be a shortage of cash.

A merchant who proposes to sell on credit should deposit in the bank an amount equal to the average credit he proposes to give and a little more; then he can draw from this to discount his bills and meet his expenses, this fund or surplus to be replenished as collections come in. But this means capital out of proportion to sales. Of course, if his credit is good he can borrow the money; but, even so, he will have interest to pay and he must watch his collections closely.

If he will use Figure 6 as a guide in issuing checks to pay his bills, the merchant will know what he is doing; he will know whether he is paying from sales returns or from surplus capital or borrowed money.

A Safe Guide

To play safe in the building of a business, you should keep a systematic record of merchandise, sell at a reasonable net profit, push your sales, sell for cash or watch your collections closely, discount your bills from net profit or borrowed capital and a safe business may reasonably be relied upon.

If your capital is small, start in a small way and expand as your net profits warrant. Do not attempt to begin where the man of wealth left off; do not overstock. Every business must have a beginning and, if conducted on a right basis, it is sure to grow.

How Often Should a Business Turn Merchandise Investment

That depends (1) upon the business and (2) upon the management of the business and (3) upon the proximity of the business to the buying market.

If merchandise investment is kept down to the actual demand, but not allowed to run short, and the sales are pushed, turnover will take care of itself. But merchandise can be kept at this point only by means of a record such as has been mentioned above.

Increasing Sales From Net Profit

No matter what be the merchandise investment, if it is in proportion to sales or probable sales, and the latter remain stationary—about the same day in and day out—the goods sold may be replenished without drawing on net profit if pur-

chases are made frequently enough to keep up the stock and not in excess of the cost of sales.

But every business man likes to see his business grow. He likes to see his sales increase from day to day. He likes to see "season" goods on hand when the season opens. This means that he must apply his net profit, or a portion of it, or the equivalent in borrowed capital, to the increase of stock.

The footing of the "Nominal Net Profit" column (Figure 5) daily, weekly or monthly will show the business man how much he can increase his stock without drawing on surplus or borrowing money to discount his bills — selling on a cash basis being understood. For a credit basis, see Figure 6.

PART TWO

Application of the Principles of Correct Figuring to Your Business

XXII

General to Manufacturing and Merchandising

Assuming that the general principles of How to Figure Profit have been so fully and clearly explained in preceding chapters as to be understood by every person who reads and studies this book, whether he be an employer or an employe, a manufacturer or a merchant, a teacher or a student, we shall proceed now with the steps necessary to putting these principles into practice in your business, whether it be manufacturing, trading or non-trading.

Business Defined

The term business as used and referred to in this book may be defined as an undertaking or activity in which capital is invested with the implied understanding that it shall yield to the investor a larger income or net profit than it would if placed on secured loan and at the same time provide him (if he be the controlling factor) with

a permanent employment at as large a salary as he could earn elsewhere in the same line.

The ownership of the capital investment and the control of the operations incident thereto may be vested in one or in more than one person, depending upon the form of the ownership, as Individual, Partnership or Corporate.

The Principles Apply to All Businesses

In preceding chapters, reference has been made principally to manufacturing, trading and non-trading businesses, with special emphasis upon the first two, they being in the majority, yet the principles and suggestions apply as well to extractive businesses, as agricultural, mining and other businesses of a similar nature. They apply to every business conducted for profit or mutual benefit.

Study Other Businesses As Well As Yours

Comparison is Beneficial—In a measure, it is by comparison with other businesses that one studies and finds the strong and the weak points in his business. It is a mistaken idea that the conditions in no two businesses are alike. While it

may be said of course that, in certain respects, the conditions in no two businesses are quite alike, yet it may also be said that, in certain other respects, the conditions in all businesses are alike. From the viewpoint of system, of correct figuring, of cost keeping, there is certainly no difference in businesses; that is, the same necessity for these elements exists in all businesses.

System the Important Factor—In other words, the elements which make for success or failure in one business will usually make for success or failure in all businesses of the same kind or class. Chief among those which make for success is system, which implies and comprehends, among other things, the keeping track of the operations of a business in a way so simple as to involve the least outlay of time and money, yet so complete in detail as to keep before the business man daily, weekly and monthly such facts and figures as will enable him to get out of his investment the highest per cent of net profit that the business is capable of producing.

It is Good Business—It is good business policy, therefore, to study other businesses than one's own; or, putting it in another way, to study other businesses in relation to one's own business. The successful attorney in preparing a case for court will

make as careful and thorough a study of the other side of the case as he will of his. He will not allow himself to be taken by surprise when the case comes up in court.

The business man will find it to his advantage to proceed similarly. It will enable him to distinguish between essentials and non-essentials; between strength and weakness; between elements which make for bigness—for growth and expansion—and those which make for a mere living.

The Difference is Marked — In studying other businesses in relation to or with a view of getting a closer line on your business, however, bear in mind that there is a marked difference between businesses which are known as manufacturing and those which are known as trading, as has been explained in a preceding chapter. These two classes of businesses represent two quite distinct lines of operation and should be studied from different viewpoints, although, in certain respects, they are not dissimilar.

A manufacturing business may be said to be the reverse or opposite of a trading business in that the working force and volume of clerical detail enter into or are connected with the cost rather than with the sale of the article, as in a trading business.

The line between these two classes of businesses may be drawn at the point where the finished article is delivered to the sales room. It is at this point the volume of detail in a manufacturing business ends and in a trading business begins.

Certain Businesses Not Easily Identified

While the identification of most businesses may be comparatively easy, yet there are some which it may be difficult for persons inexperienced in accountancy to identify or to classify.

If the business in which you are engaged involves the changing in any way (except the breaking of the original package) of the article or articles which you handle before delivery to the buyer, you may be reasonably sure that it belongs to the manufacturing division and your expenses should be grouped accordingly.

Chief among businesses belonging to the manufacturing division not easily identified are repair shops of all kinds, tailor shops, blacksmith shops, printing plants, etc.

On the other hand, every business which sells the identical thing or things which it buys, in the original or in broken lot, is a trading business.

It is true that some businesses combine manu-

facturing and trading, making one or the other the major, in which case a combination record should be kept of the two lines.

The Charting of Your Expenses

Regardless of the system of bookkeeping you keep or whether you keep a set of books according to any system, it is important that you make a complete chart of your expenses, charges and deductions as a basis for correct figuring—for establishing a selling price that will yield you a satisfactory net profit.

It Has a Twofold Purpose—A bookkeeping system is not necessary to the charting of your expenses, however important it may be to the success of your business; but the charting of your expenses is necessary to a bookkeeping system as well as to the establishing of a correct selling price.

Use the Outline as a Basis—From the standpoint of an accounting system or charting expenses, your business differs from another business of the same kind or class only in detail or perhaps magnitude. It belongs to one of three or more divisions, principally, manufacturing, trading or non-trading, and hence you need simply to know

to what one of these it belongs in order to begin to figure. When this point is settled in your mind, refer to the outline in one of the three chapters following and proceed to make up your chart. No item of expense entering into the conduct of your business, whether ledger charge or merchandise or statement deduction, should be omitted from this chart. The outline is of course merely suggestive. It may be modified in any way you see fit. For example, two or more account titles may be combined or certain ones struck out and others inserted or substituted.

While certain items of expense are common to all businesses, it is not possible to make up or even to suggest here a chart of expenses that will not need to be modified to meet the needs of each business of a kind or class. Certain items of expense enter into one manufacturing or trading business which do not enter into certain other manufacturing or trading businesses.

For example, in the grocery business a record (not an account) will need to be kept of, and a deduction from merchandise later made for, all stock spoiled, as butter, eggs, milk, fruit, vegetables, etc., under some appropriate title or head, as Spoilage. And this record should be made with the same promptness as would a record of a

sale on account. Do not put it off until the end of the day or the end of the week or the end of the month and then estimate the value of the charge or deduction.

In certain other businesses a similar record will need to be kept of Breakage, Shrinkage, etc.

The important thing is to see that every item of expense incurred in the running of your business is included under some appropriate ledger expense title, unless otherwise taken care of, as are the items above mentioned. But even these items must be taken into consideration in establishing the selling price; that is, the latter must be high enough to provide for these eliminations without cutting into the net profit to which you are entitled.

The several expense titles which go to make up the charts in the chapters following represent the expense accounts which would be opened in the expense section of the ledger in a properly systematized business and the merchandise and statement deductions. The charts are reproductions of expense charts of three of the many businesses which the author has systematized.

Of equal importance with the charting of your expense titles is the charting of your expense items under the several titles or chart heads for

a given period of time, as a month or a year, in order to determine your expense to sale in your weekly or monthly operations.

Value of the Chart Analysis—The value of making a complete analysis of your expenses according to one of the three sets of charts referred to over condensing them under one or a few account heads, as so many do, lies in the fact that it will enable you to watch the *leaks* more closely, and that it will lessen the liability of your overlooking items of expense which might otherwise escape your notice, and that it will enable you to keep a simple though correct cost system of bookkeeping if you wish so to do.

It takes no more time after the chart is once made to keep track of your expenses in this way and it insures accuracy; that is, from the standpoint of a bookkeeping system, it takes no more time to post to one account than to another if your ledger is properly arranged and classified, while, from the standpoint of figuring profit, it is essential.

If you have not been keeping a cost or even a double entry system of bookkeeping, the charting of your expenses in this way will involve what may seem to you considerable work, but it will be as nothing compared to the results. Indeed, it

will be a simple matter when you once understand the chart classification and how to treat the several groups of expense, charge and deduction which go to make up the chart.

XXIII

A Working Outline for a Manufacturing Business

The Same General Principles Govern

If you are engaged in the business of manufacturing, the same conditions confront you as confront everyone else similarly engaged, and this is true regardless of the line or lines manufactured. Manufacturing businesses differ one from another only in management, magnitude and detail.

The same general principles govern in all. The same divisions and subdivisions of cost will be found in all, although the elements which enter into these divisions and subdivisions may differ in kind and in proportion.

The same principles of cost keeping apply to all manufacturing businesses, whether the factory be on a Continuous Process or a Production Order basis, but of course a distinction must be made between these two in the keeping of the cost records.

The important thing for you to keep in mind is that you should know to the closest possible

fraction what the product you manufacture costs you. You should so keep your cost records as to know the cost per unit of raw material, productive labor and manufacturing expense. You should also know the ratio of each of these to manufacturing cost, and the ratio of manufacturing cost to sales.

You can easily figure the cost of raw material and productive labor per unit if you use a simple system of requisitions and time slips, supplemented by suitable cost records; and the manufacturing expense may be determined by following the chart outline, as may also the commercial and direct expenses.

Cost Basis

As stated in a previous chapter, the basis of cost is not the same in a manufacturing business as in a trading business, nor is it arrived at in the same way.

In a trading business, prime or delivered cost is the basis and this is established, or practically so, for the merchant. It remains for him simply to determine the ratio of this cost to sale in order to fix a selling price that will yield him the net profit he desires to make.

In a manufacturing business, however, the basis of figuring is manufacturing cost and this must be established thru a system of cost records before the ratio to sale can be determined.

A Simple System of Cost Keeping

The first thing to be considered, therefore, is the putting into the manufacturing end of your business a simple system of cost keeping that will give you on every article you manufacture and on your monthly and yearly output a correct cost basis for further figuring. The trouble with too many manufacturing plants is that they arrive at the cost basis thru guess or thru guess plus a crude system of cost records.

Exact cost figures in a manufacturing business are possible, but only thru correct figuring. You cannot keep your books by single entry or by mere double entry and hope to arrive at a correct basis. You may be too high or too low and, in either case, defeat the ends for which your business is being operated.

Information Your System of Cost Keeping Should Give You

The information of prime importance to you and which you should get from your cost records is:

1. The cost of raw material, the cost of productive labor and the manufacturing expense, these three elements constituting manufacturing cost, which is your basis for figuring profit.

2. The ratio each of raw material, productive labor and manufacturing expense to manufacturing cost.

3. The ratio each of manufacturing cost, commercial and direct expenses to sales.

Are these ratios too high? Is any one of them too high? Can the expense be cut down without reducing the output? These and similar questions should suggest themselves to you.

Prepare statements of your business similar to the following, if your bookkeeping system will enable you to do so, and study the results.

Statement I

Cost Analysis of a Year's Business

1. Ledger Charges:

Item	Amount	Reference
Raw Material	$47,972.20	Material Requisitions
Productive Labor	13,110.10	Time Records
Prime Cost	$61,082.30	
Manufacturing Expenses	8,953.17	Chapter XXIII
Manufacturing Cost	$70,035.47	
Commercial Expenses	21,846.40	Chapter XXIII
Subtotal Cost	$91,881.87	
Direct Charges	896.18	Chapter XXIII
Total Cost	$92,778.05	
Sales for Year	102,642.62	Sales Record
Nominal Net Profit	$ 9,864.57	

2. Statement Deduction:

Interest on Investment ($40,000—6%)	$ 2,400.00	Current Rate
Net Profit	$ 7,464.57	

Statement II

Profit Analysis of a Year's Business

1. Viewpoint of the Business:

Sales	$102,642.62
Less Manufacturing Cost	70,035.47
Gross Profit I	$ 32,607.15
Less Commercial Expenses	21,846.40
Gross Profit II	$ 10,760.75
Add Other Earnings	1,439.16
Gross Profit III	$ 12,199.91
Less Direct Charges	896.18
Nominal Net Profit	$ 11,303.73

2. Viewpoint of the Investor:

Less interest on Investment	$ 2,400.00
Net Profit	$ 8,903.73

The item of Net Profit represents the value of this form of investment over that of placing your money on secured loan.

Statement III

Percentage Analysis of a Year's Business

Assuming, as the two preceding statements show, that your sales for the past physical year were $102,642.62, the figures taken from your books may be tabulated as follows:

Ratio to Manufacturing Cost

Raw Material	$47,972.20	—	68.4+%
Productive Labor	13,110.10	—	18.8+%
Manufacturing Expenses . .	8,953.17	—	12.8−%
Total (Manufacturing Cost)	$70,035.47	—	100 %

The per cent to cost is found by dividing the amount of each cost group by the total manufacturing cost.

Ratio to Sales

Manufacturing Cost . . .	$70,035.47	—	68.23+%
1. Commercial Expenses . .	21,846.40	—	21.28+%
2. Direct Expenses or Charges .	896.18	—	.87+%
3. Interest on Investment . .	2,400.00	—	2.32+%
4. Net Profit	7,464.57	—	7.30−%
Total (Sales Price) . .	$102,642.62	—	100 %

The per cent to sale is found by dividing the amount of each cost group by the total sales.

It will be noted that items 1 and 2 represent the per cent of gross profit which must be made on sale ($102,642.62) to come out even, from the viewpoint of the business, while, from that of the one or ones investing in the business, items 3 and 4 should be made in addition. Item 3 represents the investors as coming out even, while item 4 represents the margin (that or more) to which those investing their money in the business are entitled for the risk taken and the responsibility assumed.

Items 1 to 4, inclusive, under "Ratio to Sales" represent gross profit—sale over cost. If 7 3/10% is the net profit desired (add the per cent the article will bring), the equivalent of the sum of the four per cents should be added to manufacturing cost to produce the price at which the article manufactured should be sold. That is, the sum of the four per cents is 31.77% — call it 32%. The equivalent of this is 32/68% or 8/17%. This added to manufacturing cost will give the price at which the product should be sold. Of course, as in a mercantile business, the *selling qualities* of the article must be considered.

Expense Charts

The following outlines will be of value in making up a set of Expense Charts.

In some businesses it may be possible to use these charts without modification, while in others it may be necessary, as previously stated, to add to, take from or change to meet the needs of the particular business.

MANUFACTURING

Demurrage and Switching—In
Depreciation of Plant
Electric Power
Experimental
Factory Clerical Help
Freight, Express and Cartage—In
Heat and Steam Power
Idle Time
Insurance—Fire
Insurance—Liability
Insurance—Boiler
Interplant Trucking
Janitor Service and Watchman
Janitor Supplies
Lavatory and Toilet Supplies
Light—Electric
Light—Gas

Miscellaneous Manufacturing Expense
Purchasing Expense
Rents—Manufacturing
Repairs to Real Property
Repairs to Buildings and Building Fixtures
Repairs to Electric Fixtures
Repairs to Machinery and Tools
Repairs to Factory Furniture and Equipment
Superintendent and Foremen
Taxes—Special
Taxes—City, County, State and School
Water.

COMMERCIAL

Accountancy Expense
Advertising Contracts
Advertising Matter
Bad Accounts
Books, Stationery and Expense
Cash Discount—Allowed
Charities and Donations
Collection and Exchange
Commissions Allowed
Crating and Shipping
Demurrage and Switching—Out
Depreciation of Office Equipment
Directors' Fees and Expenses
Expenses of Salesmen

Expenses of Officers
Freight, Express and Cartage—Out
Legal Expense
Mercantile Subscriptions
Miscellaneous Commercial Expense
Postage
Repairs to Finished Stock
Repairs to Office Furniture and Equipment
Replacements
Salaries of Officers
Salaries of Office Employes
Salaries of Salesmen
Taxes—Revenue
Taxes—Corporation
Telephone Rental
Telephone and Telegraph Tolls—Out

DIRECT

Interest Allowed
(Perhaps Others)

STATISTICAL—FOR THE STATEMENT ONLY

Interest on Investment

Cost Grouping

The Manufacturing Expenses added to Prime Cost (Raw Material and Productive Labor) will give Manufacturing Cost.

The Commercial Expenses may be in two divisions if desired—Administrative and Selling.

These added to Manufacturing Cost will give Subtotal Cost.

The Direct Expenses or Charges added to Subtotal Cost will give Total Cost.

An additional item of deduction from Earnings, in making up the Statement, although it does not go into the ledger as a charge, is Interest on the Investment. This Item should be taken into consideration in making the Statement deductions. It follows the Total Cost deduction from Earnings, the result being the Net Gain or velvet, so to speak.

Reference to Figure 1, Chapter IV, will show the respective positions of these groups of expenses in the complete chart of a manufacturing business.

XXIV

A Working Outline for a Trading Business

If you are engaged in the business of merchandising, or in any line of trading, your basis of cost for the purpose of marking the selling price will be the Invoice Price, the price you pay for the article or articles at the place of purchase; and this is true whether you treat Carrying Expense as a ledger charge or as a merchandise deduction, or whether you take the invoice price or the delivered cost as the basis.

Expense Charts

The following charts may be readily adapted to the needs of your business. Of course, you may wish to strike out certain account titles or to add others or to combine two or more in one, as previously explained.

CARRYING EXPENSE:

Freight	Cartage
Express	Parcel Post

While these items may be carried as accounts in the ledger, they are more properly chargeable to merchandise cost weekly or monthly, since they were incurred on the cost. In either case they may be grouped under one head or title, as Carrying Expense, or Transportation—In, or Freight, Express, Cartage and Parcel Post—In (unless added to the invoice price to get delivered cost).

MERCHANDISE DEDUCTIONS:

Discounts to Employes
Discounts—Miscellaneous
Mark-Downs
Mark-Outs:
Breakage
Spoilage, Etc.

The above items do not go into the ledger. They are deducted from the selling price in the Merchandise Summary weekly and have the effect of reducing the gross profit on sales as does the Carrying Expense.

OPERATING EXPENSE

Advertising Contracts (Newspaper)
Advertising—Special
Advertising Matter (Printed and Plate)
Alterations and Repairs
Association and Convention Expenses
Bad Accounts
Books, Stationery and Expense
Charities and Donations

Collection and Legal Expense
Delivery Expense
Depreciation of Store Equipment
Heat
Insurance—Fire
Insurance—Liability
Janitor and Lavatory Expense
Light
Miscellaneous Operating Expense
Nightwatchman and Street Service
Postage
Purchasing Expense
Repairs to Store Equipment
Replacements
Salaries of Employers
Salaries of Employes
Taxes—City, County, School and State

DIRECT EXPENSE:

Interest Allowed
(Perhaps Others)

STATISTICAL—FOR THE STATEMENT ONLY

Interest on Investment

Cost Grouping

The Carrying Expenses added to Prime Cost will give Merchandise or Delivered Cost.

The Operating Expenses added to Delivered Cost will give Operating or Subtotal Cost.

The Direct Charges added to Subtotal Cost will give Total Cost. This subtracted from the sum of the Sales and Other Earnings will give Nominal Net Profit.

As in a manufacturing business, a Statement deduction should be made for Interest on the Investment, and, since this is the last deduction to be made from earnings, the remainder will be Net.

As a guide in establishing the selling price, the Carrying Expense and Merchandise Deductions and the Operating and Direct expenses should be added to get the total expense to sale from the viewpoint of the business; and, from the viewpoint of the investor, Interest on the Investment should also be added.

Therefore, to determine the per cent of Gross Profit your mark-up should represent, add these expense and interest groups for a given period and divide the result by the sales for the same period and, to this result, add the per cent of Net Profit you desire to make and you will have the average per cent of Gross Profit which you should make on the marked-up price.

But this, bear in mind, is for the purpose of establishing the selling price of the stock in pur-

chasing or as it goes into the Stock Record, insofar as it may serve as a guide. The selling price is of course fixed at what the article will bring, but this should be determined at the time of buying, and it must represent a satisfactory gross profit.

When the footings from this book are taken to the Merchandise Summary, the per cent of expense to sale will be reduced by the per cent of Carrying Expense and Merchandise Deductions to sale, since gross profit will be reduced by the amount of these items.

For example, assuming that the expense to sale, which should be known at the time of buying or marking up, is 24%, which includes Carrying Expense (say, 1%) and Merchandise Deductions (say 2%), when the purchases, plus the Carrying Expense, minus the Merchandise Deductions, are brought to the Basis division of the Merchandise Summary, the expense to sale will be only 21%, 3% less than at the time of marking up, the two items of expense which this 3% represents having been deducted from gross profit in the operations intervening.

In other words, from the viewpoint of the Merchandise Summary (Basis division), the per cent of expense to sale will exclude the Carrying Expense and Merchandise Deductions.

Of course, to simply guide you in establishing the selling price, it is not necessary to divide the expenses as above, but it is better in that it avoids the possibility of overlooking any items of outlay and it may lead you to see the value of keeping a suitable cost system.

In a small business, or in any business for that matter, Carrying Expense may constitute one account.

The freight, express and cartage bills should be collected and entered daily if possible, but never allowed to run over the month.

The parcel post items may be gotten from the invoices as received and the telephone tolls from the telephone bills monthly.

A bill or statement should be made of the traveling and hotel expenses upon returning from a trip and the charge made from this.

Treatment of Carrying Expense

Carrying Expense may be made either an indirect or a direct charge to merchandise.

If it is made an indirect charge, which is not advisable, you will open an account with it in the ledger and depreciate it monthly in proportion to sales, carrying the inventory or unsold value as you do the inventory of unsold stock.

If it is made a direct charge, you may close it weekly or at once to merchandise; but pursue one method or the other—do not alternate.

Making the Purchase Price the Basis—If you close it weekly, a record separate from that with merchandise must be kept with it (in the Stock Record or elsewhere) until the close of the week, when it will be added to the week's purchases in the Merchandise Summary (Figure 7) and posted to the Merchandise account in the Ledger if such an account is kept. The posting, however, need not be made until the end of the month, when other column totals are posted.

Making Delivered Cost the Basis—If you close it at once, you will add it to the invoice price on the face of the invoice, or you may enter it in the Stock Record, as the expense is incurred, in the cost, or invoice price, column or in a column next to the invoice price. If the latter, at the close of the week these two columns should be added and the *sum* of the two footings brought to the Merchandise Summary, Cost column. This item will be the Merchandise or Delivered Cost and constitute the basis for further figuring. It is understood of course that the selling price is to be brought forward also to the Sales column.

If a ledger account is kept with Merchandise

Purchases, the same cost total (Price and Expense) should be posted to Merchandise Purchases, or this may be done at the end of the month.

Treatment of Merchandise Deductions

In preceding chapters, and in this chapter also, special emphasis has been placed on the importance of keeping track of every item of expense incurred in the conduct of your business. But a distinction should and must be made between items which are expense in the sense of ledger charge and those which are expense in the sense of merchandise deduction.

For example, take two items which we may call, respectively, fuel and spoilage. Both of these items represent an expense outlay or a charge against earnings. The first, for a given period, amounts to, say, $10 and the second for the same period amounts to, say, $4. The fuel was purchased with full knowledge of its becoming a ledger charge to expense. But the goods which were spoiled in stock and listed under the title Spoilage were purchased to sell again, to produce a revenue, and charged to stock, and they should therefore be deducted from stock (marked-

up price) rather than made a ledger charge to expense. Yet such items as this must be taken into consideration in determining the expense to sale at the time of fixing the selling price, since they represent a reduction of profit. That is, the gross profit which the marked-up price represents must be large enough to cover such items as this as well as the ledger expense charges, and this is true whether the invoice price or delivered cost be taken as the basis of cost.

The items of expense which are properly a merchandise deduction rather than a ledger charge are discounts, mark-downs and mark-outs—spoilage, breakage, etc. These items are deducted from the selling price, which reduces the profit and has the same effect as a ledger charge against earnings, except that the latter would be made monthly, while the former is made weekly, which enables you to keep a better record of stock.

Stock which is given away should be treated as a sale and included in sales and charged to some appropriate expense account at retail price, as Charities and Donations.

Operating Expenses

These are clearly a ledger charge or the equiv-

alent and include the Purchasing, Administrative and Selling expenses incurred in the regular course of your business operations and should be closed to Loss and Gain monthly, that is, if you decide to keep a cost system and take off a complete statement of each month's operations. This, however, is not necessary to the keeping track of merchandise; it is simply an added advantage to you.

Direct Expenses

As previously explained, these are properly a direct charge to Loss and Gain. In most businesses only one item of expense will come under this head, namely, Interest Allowed.

The Selling or Marked-Up Price

As stated in Chapter XIII, the selling, or marked-up, price, whatever be the amount in dollars and cents, is always 100%. This per cent is intended to cover the invoice price and all items of expense, stock and statement deductions and the desired net profit—and it will if it is the result of correct figuring and the stock is sold at the price marked.

This per cent (100) is divided into two parts,

one representing the invoice price and the other the gross profit which the selling price over the invoice price indicates *should* be made, but not necessarily the per cent which *will* be made, as will later be seen.

The ratio in per cent to selling price is determined by dividing the invoice price by the selling or marked-up price, the remainder being the per cent of gross profit which the marked-up price indicates should be made.

What The Gross Profit is Expected to Cover

This per cent of gross profit is expected to cover the following items:

1. Carrying Expense
2. Merchandise Deductions
3. Operating Expense
4. Direct Expense
5. Interest on Investment
6. Net Profit.

That is, the selling price must be placed high enough to produce a gross profit that will cover items 1 to 4, inclusive, if the business is to come out even; whereas, if the investor is to be compensated for his investment and for the risk he is taking, it should cover items 5 and 6 as well.

Therefore, in buying and in marking up it is important to know, in per cent as well as in amount, the items of expense which the selling price is expected to cover.

The amount and the ratio to sale of only one of the above items, however, is definitely known in advance of sale. This item is No. 5—Interest on the Investment. The ratio to sale of items 1 to 4, inclusive, can be determined only by previous experience and your records for any reasonable period back, as a year or a month or a week; or you may figure ahead—anticipate your sales and expenses. The figures arrived at in this way, however, will be only approximate; but they will be close enough for the purpose of marking up at least, since only a week will elapse until you know to a reasonable certainty your expense to sale—for the week. This is quite different from waiting a year for the same information, as most business men do.

Getting Down to Actual Figures

To get down to actual figures, we will assume that, at the time of marking the stock for sale, the actual and estimated ratios to the marked-up or selling price of the invoice and the items of expense and deduction previously mentioned are as follows:

a. Invoice Price	70.00%
1. Carrying Expense	1.00%
2. Merchandise Deductions .	2.00%
3. Operating Expense . . .	20.00%
4. Direct Expense	.50%
5. Interest on Investment . .	.50%
6. Net Profit (desired) . . .	6.00%
Total	100.00%

While the above figures are based only in part on fact, they play an important part in marking up. And, while the marked-up price is not the direct result of these figures, but rather that of the selling qualities of the article, yet the one marking is influenced by them nevertheless.

It will be noted that 70% of the marked-up price must be applied to the payment of the invoice, and that 23½% is to be applied to the payment of items 1 to 4, inclusive, leaving a Nominal Net Profit of 6½%.

But these figures represent simply what the *average* marking should show. Not all articles marked will show a gross profit of 30%—some more, some less, since the person marking must be governed quite as much or more by the selling qualities of the article which he marks as by the per cent of gross profit which the marked-up price

should represent. And he must be reasonably sure not only of the price at which it will sell, but that it will sell *readily* at that price. He may err in judgment, for, after all, marking up is in part a matter of judgment, except in the case of certain staples whose prices are regulated by competition or by law.

Movement of The Stock The Real Test

The accuracy of the judgment used in marking can be determined only by watching the movement of the stock. This is the real test of the selling qualities of any article of merchandise and of the judgment of the one who marks up. If the movement of the stock is abnormally slow, the price may have to be changed. This change must be kept track of and brought into the weekly summary as a decrease of profit.

The Week's Average

Whether the Carrying Expense be added to merchandise weekly or at once, the footings of the Stock Record, cost and selling prices, are brought to the Merchandise Summary (Figure 7) as of the close of the week and the per cent of gross profit represented by these footings carried out.

This per cent compared with that which may

be said to have influenced the merchant in buying, or in marking the selling prices as he did, will show how closely he kept to the basis of 30% in using his judgment as to the selling qualities of the week's purchases, the prices so marked representing various per cents of gross profit.

But, even at this point, the per cent shown by the week's footings should be regarded merely as a test of the judgment of the one who did the marking or pricing. It cannot be regarded as representing the exact results of the week's operations. This per cent will be shown later.

The Estimated and The Actual Profits

The Carrying Expense for the week should now be brought to the Merchandise Summary (Figure 7), if it was not added at once to the invoice price, and, following this, the Discounts, Mark-Downs, Mark-Outs, and Mark-Ups, if any.

The effect of the Carrying Expense, Discounts, Mark-Downs and Mark-Outs is to reduce the gross profit which the marked-up price indicated should be made on sale. But this, it will be remembered, was taken into consideration at the time of marking up, 1% having been included to meet the Carrying Expense and 2% to meet the Merchandise Deductions.

The estimated gross profit of 30% will now be reduced by the sum of these two per cents, the difference (27%) being the per cent which the week's sales should show, unless increased by Mark-Ups, if any. And this, by the way, is the effect of Mark-Ups, namely, to increase the selling price and the per cent of gross profit on sale. Goods should be marked up as the price at which they can be duplicated goes up. This is fair, since they must be marked down as the price at which they can be duplicated goes down.

Correct Stockkeeping Necessary to Correct Figuring

The study of this book will be of little value to you unless you put the principles of correct figuring into practice in your daily operations—unless you inject system into the merchandise or trading end of your business at least.

As a basis for correct stockkeeping, it is necessary that you know the cost and selling prices of every item of merchandise you have in your store.

Inventory Your Stock

The first thing to do therefore is to inventory your stock at the cost and selling prices. In future inventories you will not take cost into considera-

tion, but you should do so now to get a correct basis for the selling price.

The difference between the cost and selling prices of the inventory so taken will be the gross profit you should make in selling this stock. Divide this by the selling price and it will give you the per cent you should make. Is it satisfactory? If not, go thru your stock and see what is wrong.

The inventory which you take may be classified by departments or not, as you prefer, but it should be accurate to an item in quantity, cost and selling prices.

Merchandise Books

Only a few books are necessary to the keeping of a correct record of merchandise, which is the important end of your business. These are:

1. *Stock Record.* It is not necessary that an expensive book be used for this purpose. Any cheap two or three column book will do. This may be supplemented by a card system if a quantity record is to be kept, and it should.

The Stock Record may or may not be classified, depending upon the line you carry and the magnitude of your business. The opportunity exists for minute classification.

At the end of each week, the columns of this book should be footed and the footings brought

to the Merchandise Summary—Figure 7. This will clear the Stock Record for the next week's purchases.

2. *Carrying Expense.* The bookkeeping system you keep should take care of this thru the use of special columns. If you do not keep a double entry or a cost system, however, a record of the items coming under this head may be kept in a cheap book or in a section or in a column of the Stock Record (if not added to the invoice price at once) and the footing or footings brought to the Merchandise Summary weekly.

3. *Merchandise Deductions.* A book similar to the Stock Record may be used for Discounts, Mark-Downs, Mark-Outs and Mark-Ups—a section for each—and the footings brought to the Merchandise Summary Weekly.

4. *Merchandise Summary.* This should be a specially ruled book, corresponding to Figure 7, which see.

The first division (1) of this book, as will be noted, is for the Date—the last day of the week, except when the last day of the month comes earlier in the week, in which case that date, since the monthly results should be shown as well as the weekly results.

The second division (2) is for the Purchases for

the week, as shown by the Stock Record, cost and selling prices, and the per cent of gross profit which the selling or marked-up price represents. This will be the average of the different articles of stock marked up during the week and will test the judgment of the one who did the marking or established the prices.

The third division (3) is for the Carrying Expense for the week. This item will be added to the Cost footing of Merchandise Purchases in bringing the latter forward to the Basis division (7), since it goes to increase the cost of merchandise. If Carrying Expense is added to the invoice price at once, this column will not be necessary.

The fourth division (4) is for the Discounts which are allowed employes and others during the week. This item is subtracted from the Sale footing of Merchandise Purchases in bringing the latter forward to the Basis division (7), since it represents a reduction of the selling price.

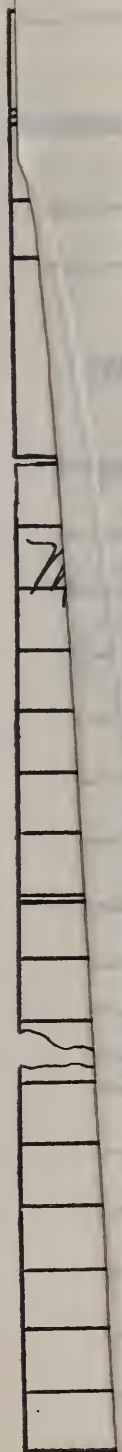
The fifth division (5) is for the Mark-Downs and Mark-Outs, which are treated the same as discounts, since they represent, respectively, partial and total reduction of selling price.

The sixth division (6) is for Mark-Ups. These are added to the Sale footing of Merchandise Purchases.

The seventh division (7) is designated as the Gross Profit Basis, which means that the figures in this division represent the gross profit which will be made on the week's sales. These figures are *net,* the additions and deductions having been made in the process of bringing the Merchandise Purchases to this division.

These footings added to the previous inventory footings will give the net merchandise cost and selling prices as of the close of the week and the gross profit which will be made on the week's sales if the per cent is carried out. This is what was meant in a previous chapter by "figuring ahead" or "anticipating profits". It represents the average gross profit you should make on sales. Is it up to your expectations? Does it represent a satisfactory net profit? These and similar questions should suggest themselves to you at the close of the week's operations.

The eighth division (8) is for the Sales for the week, which should be brought from the Sales Record. The per cent of gross profit in the Basis division (7) will be the per cent to deduct from sales to get the cost of sales, which should be entered in the *cost* column. These two footings, Cost and Sale, should be subtracted from the Cost and Sale footings in the Basis division (7) and



MERCHANDISE SUMMARY FOR MONTH ENDING ..... 19.....

DATE	DELIVERED COST					DEDUCTIONS		ADDITIONS	GROSS PROFIT BASIS				SALES			UNSOLD STOCK	
1	2				3	4	5	6	7				8			9	
WEEK ENDING 1918	PURCHASES				CARRYING EXPENSE	DISCOUNTS	MARK-DOWNS AND MARK-OUTS	MARK-UPS	COST	SALE	PROFIT		COST	SALE	PROFIT	COST	SALE
	COST	SALE									AMOUNT	%					
		AMOUNT	%														
									8000	11448	3448	30					
March 2	200	286	30		286		472	8	202 86	288 28	85 42	30	388 36	554 80	166 44	7814 50	11181 48
									8702 86	11936 28	3533 42						
9	287	413	33⅓		310		840		285 10	414 60	129 50	30⅓	391 45	617 60	226 15	7708 15	10983 48
									8487 96	12150 88	3662 92		779 81	1167 40			
16																	
23																	
30																	

Inventory at Beginning
End of First Week
End of Second Week
End of Third Week
End of Fourth Week
End of Month
Totals for Month

FIGURE 7

Merchandise Summary

the results extended to the ninth division (9) as representing the net cost and selling values of the unsold stock.

The Second Week's Operations

The second week's operations may be carried out in the same manner, and so on to the end of the month, when certain other items of charge and deduction may need be brought into this Summary to show the net merchandise results for the month, including stock returned, etc.

The Month's Operations

The inventory value of the unsold stock at the *end of the month*—cost and selling prices—should be brought to the Basis division (7) on a new page for the next month.

Take a Monthly Statement

In addition to the Merchandise Summary operations and results, a complete Monthly Statement should be taken (minus a physical inventory) if your system of bookkeeping permits of it. You ought not to allow a month to pass without having a complete analysis of your business and knowing your *net* results.

Of course, a record of stock may be kept and a weekly analysis of merchandise made without keeping a complete cost system, but the latter, it

will be found, even by small merchants, will pay for itself many times over.

Inventory at Selling Price

The keeping of a weekly summary of merchandise, as above outlined, implies the taking of your annual inventory on a basis of the selling, not the invoice, price. In short, all figuring relating to profit should be done on a basis of the selling price—the reverse of the usual practice.

The purpose of taking an annual inventory under this system is simply to verify the book inventory. If no mistakes have been made in listing the stock as it came in, or in making additions, deductions, etc., and there has been no stealing, the two inventories will agree.

XXV

Expense Chart for a Non-Trading Business

Non-trading businesses are in two general divisions, namely, Revenue and Mutual, each division being subdivided according to the nature of the business.

Revenue Business

In a Revenue business, the expenses should be divided into Operating and Direct, with an additional Statement deduction for Interest on Investment, as in a trading business.

Mutual Business

The following Chart is that of a Mutual business, said to be the largest in the state and the second largest of its kind in the United States.

It will be noted that the expenses are in one division. Not being a money-making business, but conducted and operated for mutual advantage

and benefit, a subdivision of the expenses would be of no value except perhaps for statistical purposes.

EXPENSE CHART:

Accountancy Expense
Advertising—Newspaper
Advertising—Circular and General
Agents' Convention Expenses
Agents' Fees and Commissions
Adjustment of Losses
Collection and Exchange
Depreciation of Plant
Directors' Fees and Expense
Freight, Express, Cartage and Parcel Post—In
Heat
Insurance—Fidelity
Insurance—Fire
Insurance—Liability
Interest Allowed
Janitor Service
Janitor and Lavatory Supplies and Expense
Legal Fees and Expense
Light
Losses Paid
Miscellaneous Expense
Office Supplies and Expense
Postage

Registry and Notary Expense
Repairs to Buildings and Building Fixtures
Repairs to Office Furniture and Equipment
Salaries of Officers
Salaries of Office Employes
Stationery, Printing and Supplies
Taxes—City, County, State and School
Taxes—Corporation
Taxes—Revenue
Taxes—Special
Telephone Rent
Telephone and Telegraph Tolls
Traveling and Hotel Expenses
Water

XXVI

Treatment of Certain Expense Accounts

Rent of Building

In every business and in every form of business proprietorship, if the store or factory building is rented, the amount paid for rent is an expense incurred in the running of the business and must be so listed and accounted for in the ledger.

It is clear that, if the building occupied is rented rather than owned, less capital is necessary by the value of the building.

But, if the building is owned, no separate track need be kept of the rent or of what the rent would be if not owned, it being included in the item of interest on the total investment, unless it be preferred to take the value of the store out of the capital investment, in which case such rent should be taken into consideration as the store would bring if rented to someone else, less repairs, insurance, taxes, etc. See "Interest on Investment" following.

Proprietorship Salary or Salaries

This has to do only with individual proprietorship and general or limited partnership. In either of these forms of proprietorship, not only should the salary of the proprietors who give their time to the business be charted as an operating expense, but the account should be carried in the ledger. In too many cases individual proprietors and partners fail to take into account their own salaries in listing their operating expenses, which leads them to think they are making money, whereas, as a matter of fact, they may be losing. The salary a proprietor or partner should charge should be measured by the amount another of equal ability or earning capacity filling the same position could demand.

The individual proprietor or partner who makes no charge for his services would usually not think of filling a similar position with a corporation, as secretary or manager, without being assured of a definite salary; and yet the conditions are the same, except that, in any one of the first three forms of proprietorship, he may feel that his position is more secure.

Depreciation

Estimated Rather Than Measured — This is an

account which is little understood by business men generally and not always handled in the same way even by accountants. It is confusing in that it does not represent a direct outlay of money for the charge made, that is, the charge is estimated rather than measured by a direct money outlay. Nor is there any set rule which can be followed in making a charge to this account. Conditions even in the same line differ under different managements and under different business pressures.

All items do not depreciate alike, and in scarcely any two businesses does the same item depreciate in the same ratio.

Take a building, for example, if it is kept up to a high standard — painted and repaired as needed — the per cent of depreciation will be much lower than if it is neglected and allowed to run down.

Proper maintenance and repairs will extend the life of any item of property and reduce the per cent of depreciation, but it will not eliminate it.

The charge for maintenance and repairs is tangible; it represents a direct money outlay and no one questions its place in the list of operating expenses.

If One Is, the Other Is—Now, since every charge to maintenance and repairs represents an exten-

sion of the life of the property and a corresponding reduction in the rate of depreciation, it is clear that such charge is equivalent to a charge to depreciation; that is, if one is justifiable, the other is justifiable. Therefore, if a charge for a certain amount of depreciation (Maintenance and Repairs) is justifiable, a charge for the remainder, the depreciation which is slowly but surely taking place, is justifiable and the amount can be ascertained with reasonable accuracy.

No matter how well we keep a building or an article of personal property in repair, the time will come when it will be valueless, which means that deterioration is going on, however slowly, every minute.

Charges to maintenance and repairs therefore will not wholly take care of depreciation, however much they may lessen it, and a depreciation account must be included in the operating expenses of every business, whether manufacturing, trading or non-trading.

Bad Accounts

An Operating Expense—If a collection or credit department is maintained, the expense incurred is clearly chargeable to the selling or commerical

end of the business under proper heads or titles. This department in some businesses is just as necessary as the accounting or the purchasing department.

Even though a regular collection department, so called, is not maintained in every business, a certain amount of time and attention and expense is necessary even in the smallest business and must be taken into consideration in the operating expenses.

As to the matter of accounts which are bad and charged off, however, the case may seem to many somewhat different. For example, when a sale is made, a personal account is charged for the amount of the sale and a certain profit is credited under earnings. Now, if this account should prove to be worthless, it is evident that a fictitious profit has been carried in the books and perhaps shown in the statements and a sudden, unexpected loss is the result, and possibly at a time when the management of the business can least afford it. Frequently businesses are sent to the wall because of these unexpected losses.

Create a Reserve—But the suddenness, the unexpectedness of these losses may be broken, eased up, and a financial crash averted by anticipating such losses and creating at the opening of the

account or accounts what is known to accountants and economists as a Reserve, crediting to this account and debiting to Operating expense monthly such a per cent of the account or accounts, or, in other words, sales, as will meet the probable losses of this kind as they occur. By this practice the loss is not prevented, but simply lightened, distributed over a period of time, each month bearing a little of the burden—its share. The principle is much the same as that of depreciation or insurance (in which every one now believes) and may be likened thereto.

A Necessary Evil — Of course, a strictly cash business would make this unnecessary, as it would also collection and credit expense, but all businesses do not and cannot sell for cash and this item of expense seems, therefore, to be a necessary evil. Keen judgment, good management and close attention to the sales end of the business will keep the per cent of losses of this kind down to a small item, but it cannot be wholly eliminated while a credit system is in operation.

The per cent to charge to this account monthly must be governed by experience and the attention given to accounts receivable by the management of the business.

While the item may not seem to be so necessary

to the conduct of the business as are other items of expense connected with the collection or credit department, yet it seems to creep in just the same and must be recognized in some way if a financially safe business is to be conducted.

Indeed, the keeping of this account (Reserve) will sooner or later open the eyes of the management of the business to the necessity for the closest attention to the giving of credit and to the making of collections.

Interest on Borrowed Capital

For Current Needs—There seems to be a difference of opinion as to the treatment of interest allowed for the use of money borrowed to meet the needs of the business, due very likely to the different viewpoints from which it is considered by those who study it.

Interest on borrowed capital is not an item necessary to the running of a business which is operated under financially favorable conditions; but few businesses seem to be able to run without borrowing money, which increases the expense of conducting the business by the amount of the charge for the interest allowed therefor; and this is true whether interest is regarded as a direct or an indirect charge to capital earnings.

As stated under another head, following, it is the author's opinion that "interest on investment" should not be carried in the ledger, but that it should appear in the statement. Interest on borrowed capital, on the other hand, should appear in the ledger, but not under operating expenses.

If there is sufficient capital, it will not be necessary to borrow money and there will be no interest to enter into the running expenses of the business. Therefore, since interest is not by the nature of the business a necessary item of expense thereto, it should not be added to the operating expenses of the business; but, since it represents a direct money outlay, it must of necessity, unlike interest on investment, come into the ledger, but thru what we call a direct charge to capital earnings; that is, it is charged at once to Loss and Gain or segregated to a class of accounts previously referred to as Special, Direct or Extraordinary and later charged to Loss and Gain.

In other words, in fairness to the earning capacity or power of the business it should not be charged to the operating expenses, but brought in as a special or direct charge against the profits from operations and other earnings. Of course, the fact must not be lost sight of that interest allowed is a legitimate expense to the business, but it should be properly classified.

By this classification, a business may be put on its mettle, so to speak, and its earning capacity or power or possibilities determined.

The monthly statement should be so classified as to show, to this point, five divisions of profit, corresponding to the four divisions of cost and the interest deduction, namely:

1. The profit represented by the margin following the deduction of Prime Cost or Manufacturing Cost from Sale Price, and designated as Gross Profit I.

2. The profit represented by the margin following the deduction of the Carrying Expense and Merchandise Deductions (mercantile business), and designated as Gross Profit II.

3. The profit represented by the margin following the deduction of the Operating Expenses, and designated as Gross Profit III.

4. The profit represented by the margin following the addition of Other Earnings, and designated as Gross Profit IV.

5. The profit represented by the margin following the deduction of the Direct Charges, and designated as Nominal Net Profit.

6. The profit represented by the margin following the deduction of the Interest on Investment, and designated as Net Profit.

The per cent of gross profit must, therefore, be sufficient to cover not only the expense incident to the operations, but the direct charges as well—and more, as noted.

For Construction Purposes—Money borrowed for the erection of buildings, the purchase of machinery or other equipment brings up another phase of interest charge which is also quite generally misunderstood.

To get at the matter clearly, let us assume that a certain corporation has a paid-in cash capital of $50,000. From this it expends $30,000 for buildings, machinery and equipment, reserving $20,000 for working capital.

If the business is rightly managed, it should not be necessary to borrow any money and hence there will be no interest to pay. Nevertheless, the business should yield a profit sufficient to equal at least 6% on $50,000. Of course, it should yield more to make the investment profitable, as has already been explained.

Now, let us assume, on the other hand, that the company is capitalized for only $25,000 and borrows $25,000 additional, investing $30,000 in buildings, etc., and reserving $20,000 for working capital, as before, is the situation with reference to profit changed?

True, interest will have to be paid on the money borrowed, but should it be treated differently from the interest paid on money borrowed for working capital? There is absolutely no difference. It is a direct charge against capital earnings and should be so treated in the ledger and in the statement.

The business is expected to, and will under proper management, yield a sufficient profit to pay this interest and meet the loan as it becomes due. The statement may show more, but it should show this at least, provided the loan is not out of proportion to the earning power of the business, which, of course is a matter to be considered at the time of making the loan.

Now, whether the statement shows an additional earning (nominal net) or not, the stockholders are receiving interest (dividend) on their investment to the extent of the payment on the loan, whether this be equal to six per cent, more or less; and, when the loan is fully paid up, their stock will have at least doubled in value if the plant has been properly maintained, since, whereas they started with a business worth $25,000 net, now they have a business worth at least $50,000, $25,000 having accumulated from profits. They may have received no dividend directly, but, indirectly, they have, thru the increased value of their

stock, which has been brought about by the application of the profits to the payment of the loan used to erect buildings, purchase machinery, etc.

The money paid for interest cannot, of course, in this case or any other, be capitalized. It is a legitimate expense to the business, but not an operating expense and should not be so treated.

Interest Not an Operating Expense

For the benefit of those who may not clearly see wherein interest on borrowed capital is not an operating expense, we will take a concrete example:

Let us assume that A, whose ability and training enable him to command a salary of $200 a month, desires to engage in business on his own account; but, having no ready money, he induces twenty-five friends to loan him $1000 each at 6%. This of course must be paid from the earnings of the business; that is, in return for the $25,000 which A invests, the business, after paying all operating expenses, will pay him, from the profits remaining, 6% and he, in turn, will pay this to the twenty-five persons of whom he made the loan to cover the interest thereon. What would be the difference if the money borrowed stood as a direct obligation against the business

rather than against A? Absolutely no difference. The business will pay the same interest and for the same purpose, namely, for operating capital. The amount which the business will pay A is simply a fair, just and reasonable return for the capital which he invested. It is only what every business should pay (at least) on invested capital, in fairness to those who make the investment. And this is true whether the proprietor invests his own money or money he borrows from someone else. A business is entitled to a capital investment in proportion to its producing power. If the proprietor does not supply the necessary capital and the business is forced to borrow it, the interest should be charged to the proprietor (deducted from earnings left after the operating expenses are deducted), not to the business thru the operating expenses.

And it is immaterial whether the proprietor borrows the money which the business needs or whether the business borrows it in its own name. In either case the amount represents simply an equitable investment, in return for which the business will produce a gross profit sufficient to pay all operating expenses and leave a margin of at least 6% on the capital employed or invested—if the undertaking is successful.

Of course, if the business borrows money in its own name to supply needs which should be supplied by the proprietorship of the business, the interest on the money so borrowed will be paid before the interest on the investment of the proprietorship is paid, and it is right that it should. The entry for this will involve a debit to Loss and Gain (direct charge to Capital Earnings) and a credit to Cash or Bank, as the case may be.

What is left after making this deduction from earnings belongs to the proprietorship, since the obligations of the business outside of proprietorship have been met. Hence, the deduction so made, together with previous deductions, constitutes Total Deductions from Capital Earnings—from the viewpoint of the business.

Thus it will be seen that, where the business borrows money in addition to proprietorship investment, there will be two deductions following that for Operating Expenses, one for Direct Charges and the other for Interest on Investment, not because the nature of the investment or capital employed requires that a deduction be made, but because the interest on the money borrowed should be paid first, since it represents a direct money outlay, now or at a future time, and it is therefore properly chargeable to Capital Earnings be-

fore there is a remainder which the proprietor may call his own—Nominal Net Profit.

And what is true of single proprietorship is also true of plural proprietorship, as partnership or corporate form of business organization.

Interest on Investment

Not a Ledger Account—While this can best be understood by making an analysis of business proprietorship, yet in no case should a ledger account be kept with interest on capital investment. This should be taken care of in another way.

He is Entitled to It—As stated in another chapter, a person who invests money in a business, whether the proprietorship be individual, partnership or corporate, should receive for its use the same rate of interest he would if he loaned the money at the current rate of interest on good security — and more. Every person investing money in a business, regardless of the form of proprietorship, is taking some chances and, to insure him, or partly so, against loss, he should receive more than the current rate of interest on his investment. But the interest, at least, must be provided or he will lose money. How this

should be provided depends in a measure upon the form of proprietorship, and yet, as previously stated, a distinction ought not to be made because of the form of the proprietorship.

For the Purpose of Fixing the Selling Price Only— If a person engages in business by himself (individual proprietorship) the interest should be listed with the expenses which go to make up the total expense of doing business for the purpose of fixing the selling price, but appear in the monthly and yearly statements by itself.

Should be Distinguished From Net Profit — The reason for so listing the interest item is to enable the proprietor to ascertain the gross profit the business should pay on the average daily sales to insure his coming out even on his investment independent of the net profit to which he is entitled for the risk and responsibility assumed.

Although this item of interest may be carried in the ledger in the case of individual proprietorship, or even in the case of a general or a limited partnership, it is not advisable or technically right that it be so carried.

To explain more clearly the item of interest to be included in the chart of expenses, suppose that the investment is $5,000 and the rate of interest which a secured loan would pay is six per cent,

the yearly amount of interest to list would be $300.

In a general partnership, interest on the two or more investments may be treated in the same way and must be viewed in the same light by the partners investing in the business. This of course must not be confused with interest on loans made by the partners or on money left in the business by them.

Treated the Same—In these two forms of proprietorship, while the monthly and yearly statements will show the conditions exactly as they should be, in the loss and gain account in the ledger this item of interest will appear as an increased earning; that is, if no account is kept with it, as there should not be, there will be no debit or deduction against the earnings, as there will be in the statement. But it is not necessary. The loss and gain balance is closed to the proprietorship account or accounts, as the case may be, thus giving this account or these accounts credit for the profit which the business has produced, the interest on the investment not deducted.

The purpose of the statement is simply to show the financial condition and the earning capacity or power of the business, its strong and its weak points, etc.

Stockholders Entitled to Interest—In the light of interest on the money invested and the extra compensation for the risk taken, a corporation is not materially different from the other two forms of proprietorship, except that an account with this particular interest should not be carried in the ledger, whatever may be the excuse for carrying it in either of the other two forms. This item should be taken into consideration, however, in charting the expenses and in making the statement, as in the other two forms of proprietorship, and the gross profit should be sufficient to meet it and show a net profit besides.

In other words, a person investing in a corporation should expect to receive a sufficient dividend to cover the current rate of interest on his investment and at least as much more to compensate him for the risk taken, otherwise he might better place his money where he would be sure of the current rate of interest as well as the principal, and be relieved of all anxiety in regard thereto.

The extra amount to which the investor is entitled may be paid in the form of an increased dividend or it may be passed to surplus for expansion purposes, thereby increasing the value of the stock.

Of course, there are business corporations

which do not pay even the current rate of interest on the money invested, directly or indirectly, but that is not, under ordinary circumstances, a credit to the management or to the judgment of the stockholder who invested his money.

PART THREE

By Way of Suggestion

Chapters XXVII to XXVIII

XXVII

A Bookkeeping System

As stated in the Introduction, it is not the function or mission of this book to go into the details of systematization or accountancy, yet whatever be the kind or nature or purpose or magnitude of the business, or whether the proprietorship be Individual, Partnership or Corporate, a bookkeeping system is necessary to the safety of the money invested and to the growth and development of the business.

Single Entry

Unfortunately, too many persons in business are content with keeping accounts with persons only, which has to do merely with collections and payments, disregarding the accounts which have to do with the life and soul of the business.

No business can produce the profit on investment possible whose management is satisfied to wait until the end of the year to find out the net gain or loss for the year or, worse yet, to go on indefinitely without this information.

The purpose of a physical or periodical inventory should be simply to verify the book figures, rather than to make a financial or a loss and gain statement possible.

Double Entry—Cost System

While the system of bookkeeping employed should show, among other things, the correct value of the assets and liabilities, the expenses involved in the conduct of the business and the earnings from the capital at work in the business, yet no system is complete, whether simple or complex, which does not enable the management to know to a reasonable certainty, daily, weekly and monthly, the profit made on every dollar's worth of goods sold, the cost of the goods sold, the value of the stock on hand, the expense involved in effecting the sales and the earnings from the sales, etc.

The way to stop a leak is to prevent it and the time for this is before the loss occurs. What it would cost to prevent a leak would be only a fraction of the loss sustained thru the leak.

Why They Do Not Keep Books—Some business men say that they do not keep books because the expense is too great, but the loss they sustain in

not keeping a set of books they do not seem to mind at all—because they do not know what they are losing or wherein they are losing. They are simply groping in the dark. As a rule, business men waste more time during dull hours than would keep up a cost system.

Adapt the System to Your Business—If a bookkeeping system is adapted to a business, rather than a business to a system, the time and expense will be small compared to the results. The simpler the system of course in any business the better, but it should be complete. If a bookkeeping system is necessary in a large business, it is necessary in a small business, but on a proportionately small yet complete scale.

It Does Not Imply a Cost System — One thing which should be put down as a settled fact is that double entry bookkeeping is necessary to a cost system, but it does not imply a cost system; that is, the mere fact that a set of books is being kept by double entry does not imply that a cost system is being kept, neither does it imply any particular degree of system, as the term is known in accountancy. Double entry is a step from single entry towards system, but it is not in itself system.

A Cost System Possible — Again, a cost system (simple of course) is possible even in a hotel or in

a restaurant or in a barber shop, as well as in the largest manufacturing or mercantile business, and just as necessary. A business grows in large part thru system. A large business is large usually because of system, and a small business is small usually because of a lack of system.

No More Time Involved—Again, double entry, rightly installed, involves no more time or labor than single entry, except a few minutes at the end of each month, and a complete cost system involves but little additional time—not enough to be considered in comparison with the satisfaction of knowing daily, weekly, monthly and yearly the exact condition of one's business and whether he is making or losing, wherein and how much.

XXVIII

Mutual Understanding

Educate the Public

Every insurance agent will testify to the fact that the more enlightened a prospect is on the subject of insurance, the more easily and quickly and satisfactorily business can be done with him.

The same is true of business in general. The better business is understood, the more the public know about it, especially the technical side, the sooner will the business man gain their confidence, the more likely he will be to get their patronage and co-operation and the less likely they will be to doubt or even question his right to the profit he makes. On the contrary, they would respect him more for making a profit than they would for selling at a loss. The average person at least wants to see all other persons succeed and prosper.

Therefore, the sooner the public become educated to the fact that business men must make a reasonable profit and that they are making only a reasonable profit, the better it will be for the

business men. Indeed, if business men could go so far as to tell their customers, as a few are now doing, that all net profit over 5% would be returned to them at the end of the year in the form of a dividend they would add to their surplus thru increased sales.

The confidence of those with whom we deal is a great factor in the building of a business. There should be no secrets about a business which is rightly conducted, and there would not be if the public rightly understood the expenses involved in the conduct of a business and the necessity for a reasonable net profit.

A Word to the Consumer

Because a retail merchant's prices seem high to you do not think he is robbing you. The reason for high prices may be well-founded. It may be no fault of the merchant. He must make a sufficient profit to cover the expense of doing business and a little more—he is entitled to at least 5% net, but not all make that. They think they do, but they do not seem to get ahead. Their theories and the net results do not agree and this should be apparent to you.

Most men in business are honest. They could

not do business year in and year out on any other basis. If the retailer, or middleman, is to be considered a factor, if he has a place in business, he must do business on a business basis; he must make his expenses and a reasonable profit besides. Do not forget that it costs money to handle goods; that the retail merchant buys in much larger quantities than you buy of him and at a lower price than you could buy in small quantities of the same source from which he buys; that his investment is much larger and his risk much greater than yours; that he brings to your door the articles you would otherwise have to go some distance to get or take your chance in getting thru circular or catalog description—and that all this involves an expense which you should be willing to stand in return for the convenience and satisfaction and promptness of the service which he renders you.